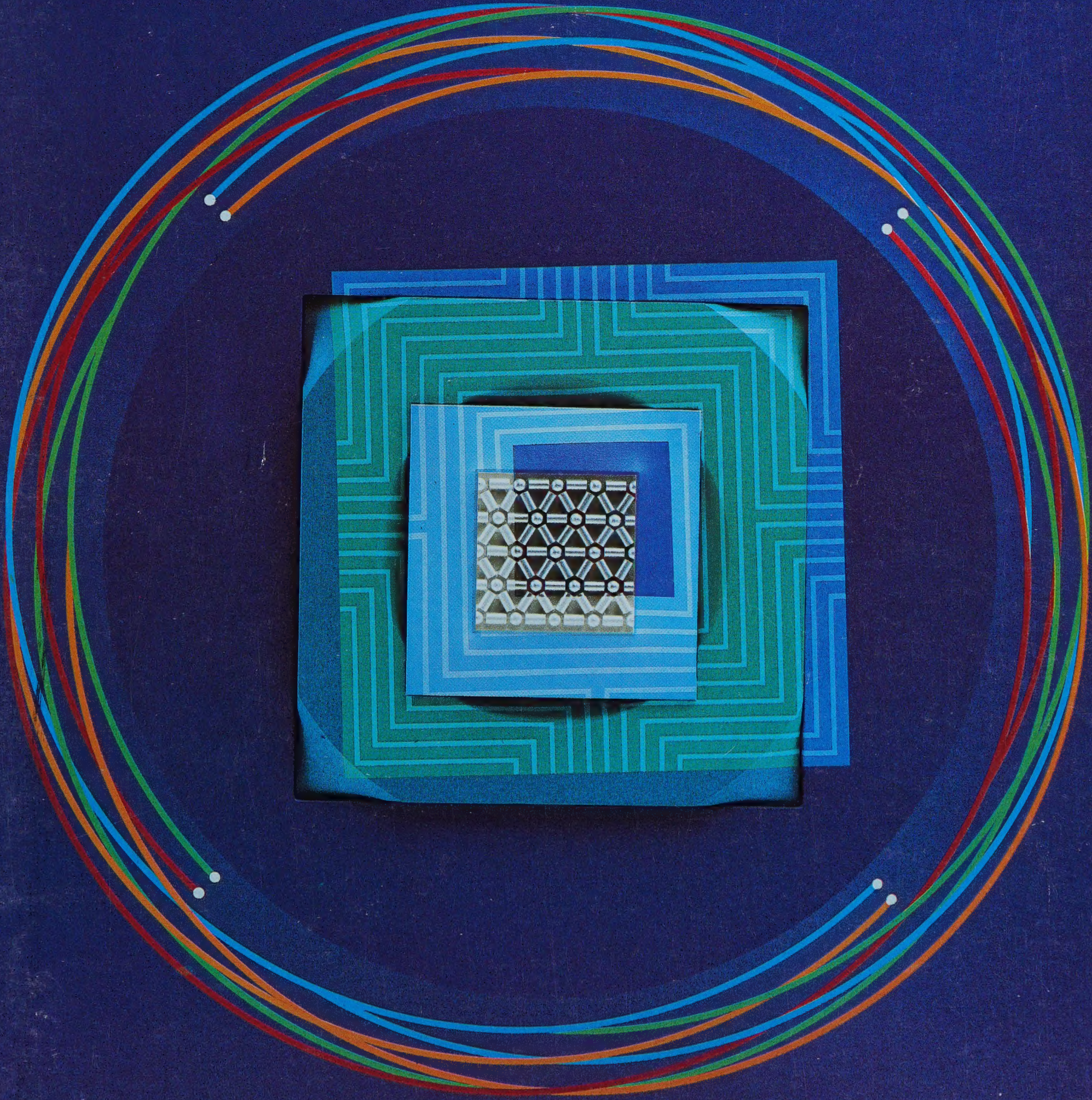
AR53

AT&T

1984 Annual Report



American Telephone and Telegraph Company

1985 Annual Meeting
The one hundredth Annual Meeting of AT&T shareowners will be held at 9:30 a.m. on Wednesday, April 17, 1985, at the David L. Lawrence Convention Center in Pittsburgh, Pennsylvania.

Stock and Bond Information
Information about AT&T common and preferred stock, bonds, dividends or interest payments and about the Dividend Reinvestment and Stock Purchase Plan can be obtained from the company's transfer agent, American Transtech Inc., by calling without charge: 1 800 631-3311. Mailed inquiries should be addressed to American Transtech Inc., AT&T Shareowner Contact, P.O. Box 2566, Jacksonville, FL 32232-0086.

Certificates and documents in support of stock transfers should be addressed to American Transtech Inc., AT&T Transfer Services, P.O. Box 2420, Jacksonville, FL 32232-0085.

American Transtech maintains an office for bank and broker services at 250 Broadway, 15th Floor, New York, NY 10007.

Shareowner Information
Available upon request, by writing to the Secretary's Department, AT&T Co., Room 3200P2, 550 Madison Avenue, New York, NY 10022, are:

- Form 10-K, AT&T's annual report to the Securities and Exchange Commission.
- Information on charitable contributions.

As a service to visually impaired shareowners, the AT&T annual report will be available on audio cassettes.

General questions or comments about the company should be directed to: Corporate Vice President and Secretary, AT&T Co., Room 3309, 550 Madison Avenue, New York, NY 10022.

The company's telephone number is 212 605-5500.

Inside This 1984 Annual Report

Illustrations
Several of the country's leading illustrators were asked to depict aspects of what they see as the essence of the new AT&T. The cover illustration by Steve Tarantal, the computer-generated art (using AT&T's UNIX operating system) on Page 7 by Judson Rosebush and Don Leich, and the one on Page 10 by Wilson McLean focus on the globalization of AT&T, the integration of Information Age technologies into systems, and our efforts to universalize information services as we universalized telephone service. The illustration on Page 4 by Michael Dudash represents AT&T people in the person of a systems technician. The illustration by John Berkey on Pages 8 and 9 suggests the range of AT&T's customers and services.

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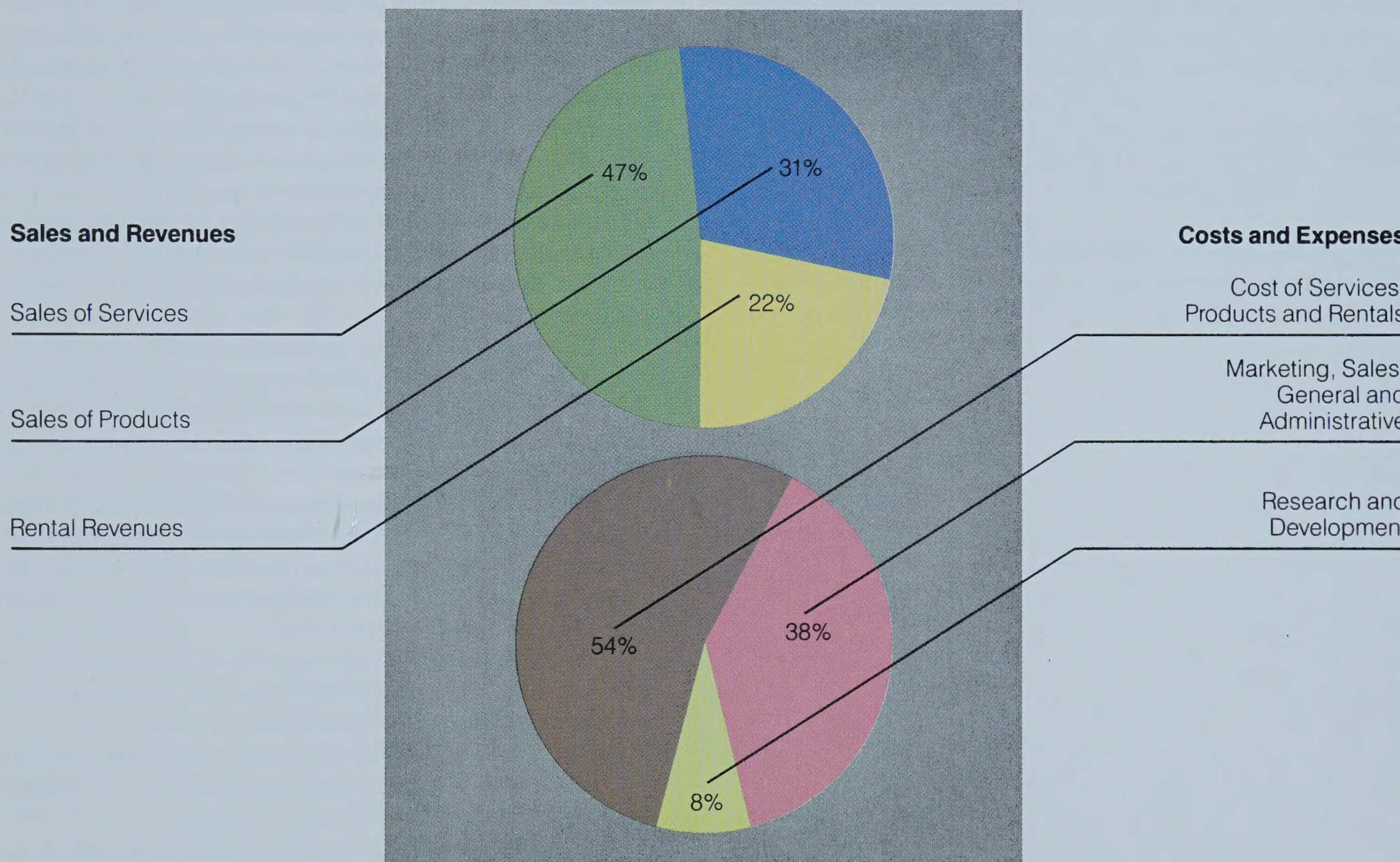
DOLLARS IN MILLIONS (except per share amounts)

Total Operating Revenues	$33,187.5
Total Operating Expenses	$30,893.3
Net Income	$ 1,369.9
Earnings per Common Share	$1.25
Dividends Declared per Common Share	$1.20
Return on Average Common Equity	9.48%

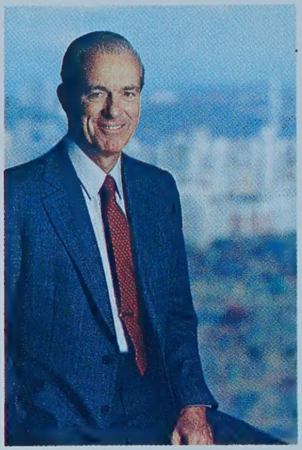
Operating Revenues and Expenses in 1984



Sales and Revenues. Almost half of AT&T's 1984 operating revenues came from sales of services, including long distance services, operator services, installation, maintenance, repair, user training, and customer support. About 31 percent came from the sales of products, including switching and transmission systems, PBXs (private branch exchanges), computers and telephones. Rental revenues, principally from the rental of embedded (in place) customer premises equipment, contributed the remainder, 22 percent.

Costs and Expenses. In 1984, 54 percent of our operating costs and expenses was directly related to the cost of products and services we sold. Marketing, sales, general and administrative costs accounted for 38 percent of our operating expenses. We focused major cost-cutting efforts on this latter category of expense, and will continue to give special attention to reducing staff functions and overhead expenses. The initial results of these cost reductions have been gratifying, although we expect their full benefit to become increasingly apparent during 1985. The remainder of 1984 operating expenses, 8 percent, went for research and development as we continued our commitment to support both basic and applied research. The support of both fundamental research and new product development is an essential investment in the future.

For a more detailed discussion of the company's 1984 operating results and financial position, please consult the financial section of this annual report, beginning on Page 13.



Charles L. Brown
Chairman of the Board

Dear AT&T Shareowner:

I had said from the outset that 1984 would be a difficult year. It was.

But difficulty does not imply distress.

What I have sought to convey throughout the year is my own sense of optimism about the future, together with a realistic appraisal of the near term consequences of divestiture, namely: You cannot divest the core of a flourishing business–in our case, the telephone exchange business–and, overnight, rebuild in its place a new enterprise.

Now what I seek to convey to you is that in the midst of last year's difficulties we have established a basis for the successful transformation of the company.

Difficulties will persist, of course, but what is now so evident is the emergence of an altogether new enterprise eager to demonstrate its newfound market focus and confident in its commitment to financial goals that can generate and sustain a significant growth in earnings.

The evidence of our transformation can readily be summarized.

Customers liked what we had to offer. The marketplace demand for our flagship products was strong. And where long distance customers were asked to choose among competing long distance companies, a solid majority stayed with AT&T.

We continued to demonstrate at AT&T Bell Laboratories leadership in research and development, especially in the silicon-based technologies. And we showed that we not only know how to develop and make innovative products, we know how to *market* them as well.

We further established ourselves in Europe and in the Far East, the two most important markets for our products and services outside the United States.

We are encouraged by the government's stated willingness to modify old regulations that still hamper our ability to compete on even terms with our competitors.

And as we began to move the enterprise in new directions, there has emerged within the company a spirit of managing more aggressively and of coming to decisions faster–a spirit of being on the move.

But most encouraging of all was that the people of AT&T demonstrated that they know how to be competitors. They know how to design, develop, manufacture, market and sell high technology products, services and systems in markets that are intensely competitive.

One of the principal adjustments we have had to make is to lower our cost structure and improve our margins. We had to come to grips with the fact that not all of the work done when we were "the telephone company" has a place in this new business environment–and that we could operate with a much smaller management force. As a result, jobs have been eliminated through attrition, voluntary and involuntary retirements and layoffs. Four of our manufacturing plants

are in the process of being closed. Salary structures are frozen through 1985 for all management employees.

In short, the stable work environment of the past is yielding to a new kind of environment and new indices of success and failure: Rapid change. Greater risk. Greater individual accountability.

Financial Performance

Our earnings for the year—$1.4 billion in net income, $1.25 per share—are a disappointment. We expected to do better. (Highlights of our 1984 financial results can be found on Page 1 and a detailed financial report starts on Page 13.)

In some lines of business our sales were lower than we anticipated. Shortages of some components that go into our larger systems delayed shipments to customers. The charges we pay the local telephone companies for customer connections were higher than we thought they would be.

Some of the factors bearing on our financial performance in 1984 are attributable to problems created by divestiture. But not all of them. Some reflect gains made by competitors in markets where we had previously faced little competition. Some were the result of regulatory rulings. Some were of our own making.

That was last year. We intend to do better in 1985 and better still in the years ahead.

In the meantime, AT&T remains a financially strong company with nearly $40 billion in assets and excellent prospects in rapidly growing markets. We built a reputation over many decades as a solid, blue chip investment that paid dividends to shareowners in good times and bad. That reputation has served us well down through the years and we mean to keep it.

Outlook

As we move into 1985 and beyond, we look to level out the ups and downs that characterized our earnings in 1984 and assume an upward trajectory that will merit the continued confidence of our shareowners.

We will be introducing new products and systems that will strengthen our market position in the businesses in which we operate.

We will be getting our products out of the factory and into the hands of our customers more quickly.

We will be continuing our efforts to reduce our costs to ensure that we can price our products and services competitively with other companies whose costs are now lower than ours.

We will be pressing our efforts in Washington and in the states to lessen unfair and unneeded advantages—including cost advantages—that government regulations now afford our competitors. We want AT&T's customers to get the full benefits, including lower long distance prices, that competition is supposed to promote for consumers.

Most of all, we expect to continue in all we do to meet what is our overriding goal: that is, to satisfy our customers, one by one. We will do that by rewarding our employees with good pay and good jobs for good performance, and by producing quality, reliable products and services at competitive prices, backed up by the best service in the world.

Nineteen eighty-four was a good beginning for us, but it was only a beginning.

A chronicle of 1984 would be incomplete if I did not acknowledge the retirement during the year of AT&T officers who played critical roles in carrying out the very complicated task of divestiture and then helping to launch this new enterprise: Bill Ellinghaus, Bob Flint, John Fox, Walter Kelley, Rex Reed, Bill Sharwell and Ken Whalen.

Similarly, though their names are too numerous to mention, the year saw the retirement of many other fine AT&T people, both management and non-management.

They will all be missed.

So too will we miss Jerome Holland, who died recently. His contributions to this business were many since he joined our board of directors in 1972.

C. L. Brown
February 8, 1985


C M DUDASH

AT&T's business is the electronic movement and management of information —in the United States and around the world.

AT&T people provide:

• Domestic and international long distance telecommunications services for residence and business customers and special voice, data and video services for businesses and governments.

• Network systems—switching, transmission and computer-based operations support systems—for telecommunications companies and governments.

• Information systems for businesses of all sizes—including office communications systems, enhanced networks, workstations, computers and software.

• Telephones and other related products and services for consumers.

• Special systems for the Federal government.

• Electronic components, including computer memory chips and microprocessors, for our own use and, selectively, for outside sale.

The key to the movement and management of information in this electronic era is to bring communications and data processing technologies together into systems that address individual customer needs. Our competitive edge comes from our demonstrated ability to design and manage complex, interactive systems.

Each of our business units is responsible for contributing to the company's overall goal of increasing the value of our shareowners' investment.

Our long distance business remains regulated by the FCC and, in the states, by public utility commissions. The rest of our businesses are for the most part unregulated.

The markets we serve are highly competitive and subject to rapid changes in technology and customer needs. We intend to focus our resources on those markets where our opportunities for sustainable growth are strongest and the opportunities for profit most promising.

Fundamental to our success in these technology-based markets is our ability to stay out front in research and development.

In 1984 a restructured AT&T Bell Laboratories continued its basic responsibility: supporting our individual lines of business by designing and developing new products, systems and services while, at the same time, carrying out a broad program of fundamental research to provide the technological foundation for our future. Bell Laboratories also assumed responsibility for the oversight of research and development being done throughout AT&T.

To speed up the introduction of products and services, we strengthened the links among our network planning, development and manufacturing processes. We also established new ties among our development, manufacturing and marketing organizations.

In all our key research areas we continued to expand the knowledge base of the three information technologies common to our businesses: microelectronics, software and photonics (lightwave).

In short, our research and development people provided the technology we need to be a world leader in information systems and services.

Major Developments

AT&T Bell Laboratories' development of a one-megabit memory chip—discussed in more detail on Page 11—was a clear indication of AT&T's determination to remain one of the nation's and the world's leaders in advancing new technologies.

We set records for transmitting information by lightwave at incredibly fast speeds (up to two billion bits per second) over long distances without having to amplify the signal along the way. With this technology, which has important applications in our business, messages are transmitted as pulses of light, using ultra-pure glass fibers and powerful lasers.

A new generation single-mode fiber lightwave system was developed. With the largest capacity of any commercial lightwave system, it will carry vast amounts of voice, data, video and graphics at very high speeds.

A semiconductor circuit, operating at higher switching speeds than any known silicon circuit (up to 90 billion operations per second), was demonstrated. This new circuit could have a significant effect on the design of high-speed computers and data processing systems.

The WE® 32100 microprocessor was a major achievement. This fastest, most powerful 32-bit microprocessor was brought into use in only 11 months, one-third the normal development time.

In the field of artificial intelligence, in which scientists are seeking to simulate human reasoning in computer systems, we developed a new software system that can design a microcomputer-on-a-chip in a few hours rather than the months it usually takes.

New developments also were achieved in production techniques, including computer-aided design.

Finally, the astonishing problem-solving speed of a new algorithm developed by an AT&T Bell Laboratories mathematics researcher raised hopes for broad new areas of linear programming applications.

We began marketing our long distance telecommunications services in new and more vigorous and innovative ways.

AT&T Communications endeavored in 1984 to increase customer awareness of AT&T as a long distance company and to differentiate our long distance services from those of our competitors.

Departing from our traditional pricing methods, we introduced Reach Out℠ America, offering one hour of interstate long distance calls on nights and weekends for $10 per month and additional hours for $8.50. For an additional $1.50 per month, customers receive a 15 percent discount on all calls during the evening period.

Another new program, AT&T Opportunity Calling,℠ allows residence and business customers who make more than $15 a month in AT&T long distance calls to earn credits for discounted purchases of merchandise and services. Customers get one dollar of "opportunity credits" for each dollar they spend on AT&T Long Distance Service.

Vigorous marketing—supported by the voluntary efforts of many AT&T employees—was particularly evident as the local telephone companies began offering other long distance companies the same kind of local connections that AT&T uses. As these equal access connections are implemented, customers are being asked to choose a primary long distance company. Generally, customers who do not make a different choice keep their AT&T service.

AT&T Long Distance Service offers the best overall quality and value for long distance calling. We provide operator assistance around the clock, the ability to call from anywhere to anywhere, guaranteed discounts more than 70 percent of the time, and immediate credit for misdialed or disconnected calls.

For more information about our long distance services, call toll-free: 1 800 222-0300 for residence needs or 1 800 222-0400 for business needs.

Major Developments

Among AT&T Communications' new service offerings was a digital service for businesses, Accunet® packet service. A more efficient way of sending some kinds of data, it uses electronic technology to break data messages into packets of up to 256 characters and transmit them to different locations, where the packets are reassembled into messages.

We offered new optional features for AT&T Advanced 800 Service and distributed to more than a million households and businesses a directory with thousands of toll-free 800 numbers.

With our new Alliance℠ teleconferencing service, customers can set up their own teleconference calls with up to 59 locations.

AT&T Card Caller public telephones were installed in airports, convention centers and hotels. Calls are made with one of our new AT&T Cards or, in some cases, an American Express card. Billing is automatic. We distributed some 50 million AT&T Cards.

AT&T Communications began extending more of its domestic services overseas—including international video teleconferencing, AT&T International 800 Service and Dial-It® 900 service. Also, agreement was reached with 28 nations for AT&T to design and build the major part of the eighth transatlantic cable (TAT-8), the first to employ lightwave technology.

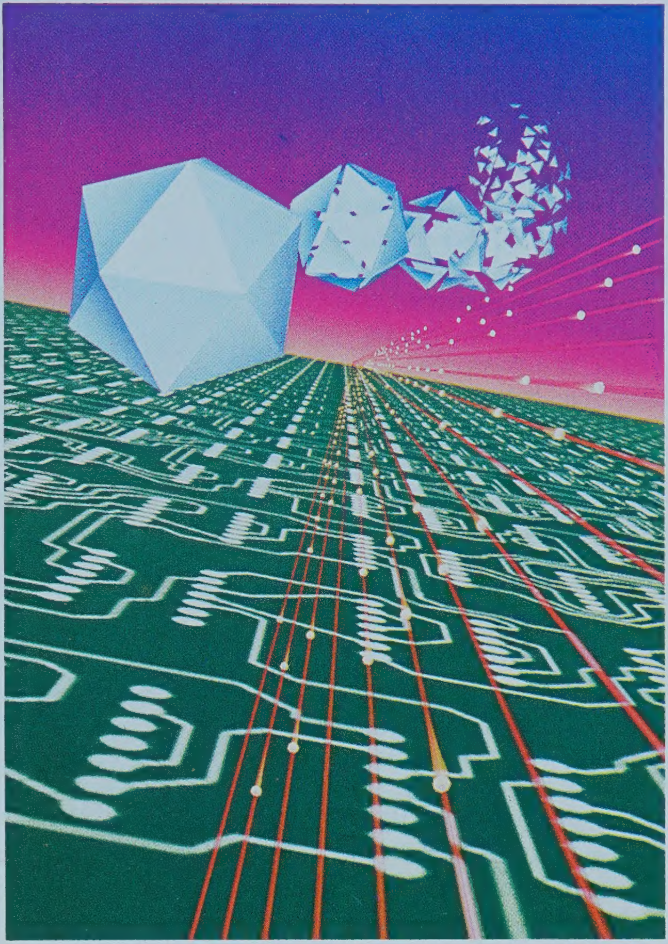
Meanwhile, the AT&T telecommunications network continued its evolution to a largely digital system. A digital network will reduce our operating costs and give us more

flexibility in moving information, whether voice, video or data. Customers literally will be able to design their own long distance services.

We announced plans to construct by the end of 1990 an extensive network of lightwave facilities. And we launched our second Telstar 302 satellite, this one from the space shuttle Discovery.

The year was not without problems. Because of divestiture, new systems for providing our business services had to be developed with the divested Bell companies. When the systems did not operate as intended, we were faced with a backlog of service orders. But by late summer, WATS and 800 Service orders were back on track, and by year-end we were approaching normal service levels for private line orders.

All other categories of our long distance service were as good or better than before divestiture.



Regulatory Activities

AT&T is the only long distance company whose prices and service offerings are still fully regulated. Even though this market has become intensely competitive, we pay more than twice as much as our competitors for connections to local customer lines.

What we are seeking, both in Washington and in the states, is the freedom to compete on even terms with other long distance companies.

There was some improvement in Federal regulation in 1984. The FCC in May ordered an 8.5 percent reduction in the charges we pay local telephone companies for connections to customers. (These "access charges" are AT&T Communications' single biggest cost–almost 60 percent of its gross revenues.) This in turn made it possible for us to reduce our interstate and international long distance prices by 6.1 percent.

In many state jurisdictions the charges we are required to pay for local connections range from 80 to 95 percent of our intrastate revenues. This resulted in overall losses in our intrastate business in 1984.

As the year progressed, some states began taking a more flexible approach to regulating our intrastate services. Virginia eliminated rate-of-return regulation entirely, and several other states gave us much more flexibility in the way we price our services.

As the carrier selection process referred to earlier plays out through September of 1986, our principal competitors in the long distance business will incur the same charges we pay for local connections where equal access has been made available. Thus, the artificial cost advantage currently enjoyed by other long distance carriers should be reduced substantially over the next two years.

As the year ended, the FCC approved a customer line charge of $1 a month for residence and small business customers starting in mid-1985 and rising to $2 a month in mid-1986. Larger business customers already pay a $6 line charge. These charges are paid to the local telephone companies and will be accompanied by decreases in long distance rates. The purpose of the customer line charge is to reduce the subsidization of local telephone service by long distance customers.

In other actions, the FCC approved a 50-cent charge, after two free calls, for interstate long distance directory assistance calls. This charge is meant to recover part of the costs we incur from the telephone companies that provide the service.

Providing network systems to telecommunications companies is a business in which we are second to none in our understanding of the market and our ability to serve it.

Through AT&T Network Systems, we sought in 1984 to retain our market position as the principal supplier of telecommunications systems and equipment to the local Bell

companies. In addition, we began working with other telecommunications companies in the United States and around the world, as well as with government customers and original equipment manufacturers to acquaint them with our network systems product line.

We recognize that many customers will continue to rely on a single, general purpose network–in preference or in addition to special service networks–to transport voice, data, images and other types of messages.

In working with the companies that own and operate segments of the telecommunications network, including AT&T Communications, the aim of AT&T Network Systems is to support the investment they already have made in network systems while continuing to offer them new revenue and cost-cutting enhancements.

To increase our production capacity and ensure our ability to serve this market more effectively than anyone else, we are implementing state-of-the-art manufacturing processes, including the use of robotics.

Major Developments

There was unprecedented growth in demand for our 5ESS™ switch, a digital switching system with a modular design that can serve population centers of any size. Toward the end of the year we shipped our two-millionth line of this equipment. In 1985, continuing a large and rapid product buildup, we will produce up to six million lines.

We made significant efforts during the year to upgrade the Centrex service capabilities of switching systems we provide the telephone companies. With Centrex service, a business customer's telephone switching capability is provided through computer-based electronics in the telephone company's central office.

In addition to switching systems, we provide transmission products and systems with capabilities ranging from the connection of a single line to the networking of information between cities and countries.

AT&T is a leading supplier of products, systems and components for lightwave, or fiber optics, communications. Lightwave technology is rapidly becoming the transmission technology of choice for both local and long distance telecommunications.

Thus, we continued to increase our shipments of single-mode lightwave fiber. A special, high-strength version of this fiber is being manufactured for use in undersea cables, including the transatlantic lightwave cable planned for service in 1988. The first shipments of a still newer generation single-mode fiber lightwave system are expected to be made in 1985.

AT&T is also the leading supplier of operations support systems in this country, and we are seeking new customers overseas.

Meanwhile, some of our traditional customers are beginning to benefit from a nontraditional technology in operations support systems. An example still in the trial stage is the Automated Cable Expertise (ACE) System. Using artificial intelligence techniques based on AT&T Bell Laboratories research, the system economically and efficiently analyzes outside plant maintenance.

In the growing market for business automation systems, our unique strength comes from our long experience in developing and applying both telecommunications and computer technologies.

Success in this market will be achieved by companies whose products and services bring together voice *and* data functions, and who therefore can offer business customers

total system solutions and end-to-end responsibility for meeting their information management needs.

And so in 1984 we brought to market new, innovative products that integrate voice, video and data capabilities with other functions that help customers improve the management of their businesses and reduce their costs.

In early 1985 we strengthened our ability to integrate tailor-made communications and data processing systems by teaming up in a multi-year agreement with Electronic Data Systems, a General Motors subsidiary.

The services our people provide business customers include designing and engineering networks, and custom-designing software and hardware for information systems. We offer flexible service contract options, including one that gives customers a single number to call for service. For users of AT&T computers, a toll-free hotline is available 24 hours a day to resolve hardware and software problems.

Major Developments

In a further restructuring of our AT&T Technologies organization, we are bringing together key organizational resources into three lines of business within AT&T Information Systems. The three are: large business systems; computer systems; and consumer and general business systems. A single national services organization will support all three. This realignment is designed to make it easier for customers to do business with us.

Customer response to our new System 75 was exceptionally strong. This new digital PBX (private branch exchange) for medium-sized businesses, introduced in the U.S. and Canada, offers features and functions that before were available only with our larger System 85. A PBX is, in effect, an information controller that connects a business customer's voice and data terminals.

We more than doubled the capacity of our System 85, which can now handle from 300 to 32,000 voice/data terminals. A voice mail system, Audix, was introduced to work with System 85.

Sales of our microprocessor-based Merlin™ communications system for small businesses exceeded our expectations, accounting for nearly a third of the sales of small office systems by our Business Service and Sales Centers.

Our Information Systems Network set new standards in local and wide-area networking technology. It allows customers to link workstations, terminals, computers and other equipment into one easily managed system which can also be connected to our PBX products.

One of the stumbling blocks to the full realization of office automation has been the inability of one vendor's data processing equipment to work with another's. To overcome this problem, we introduced our Information Systems Architecture, a communications-based concept to ensure that our own products—including our computers—are compatible with each other and with other vendors' products.

AT&T Teletype Corporation continued to introduce new products, among them a new family of printers, including portable and table top models.

In regulatory matters, we are seeking the removal of rules that continue to require structural separation between AT&T Information Systems and the rest of the enterprise, including our other unregulated activities. These rules, formulated in 1980, no longer serve any useful purpose now that the divestiture is behind us.

Computer Systems

One of the most significant events of 1984 was our entry into the general purpose computer business.

We entered the computer market with strong credentials. Indeed, many of the computer industry's basic inventions originated at AT&T Bell Laboratories. We have been making computers for our own use for many years, but it was not until now that we were allowed to market them widely outside our own doors.

Computer hardware and software systems play a major part in our strategy to provide integrated communications-based office automation systems.

Early in the year AT&T Technology Systems unveiled a

family of high-performance 3B computers, ranging from a desktop supermicro to a powerful superminicomputer.

All use the UNIX™ System V operating system developed by AT&T Bell Laboratories. A computer's operating system is a collection of software programs that control the system's hardware and applications software. The UNIX System, licensed to more than 80 computer manufacturers, is well on its way to becoming a worldwide standard in the industry. It is the only commercially available operating system that can be used across a broad span of computers: from large mainframe computers to the much smaller microcomputers.

Three months after our initial announcement, AT&T Information Systems introduced the AT&T Personal Computer PC 6300 and a variety of new software products. The PC 6300, manufactured by Ing. C. Olivetti & Co., uses the thousands of MS-DOS software packages already available for business and home applications. It operates with our UNIX-based 3B computers through the AT&T PC Interface.

The PC 6300 is being sold by our own sales people and through more than 900 computer specialty retailers. It can also be ordered by calling toll-free: 1 800 247-7000.

AT&T Information Systems' sales force has undergone intensive training in computers, applications software and local area networks. A thousand of our systems technicians have been retrained to service these new products.

We continued our leadership in the consumer telephone marketplace.

We introduced 36 new telephone products for residence and small business customers and expanded by more than a thousand the number of retail outlets where they could be bought.

New consumer offerings in 1984 included the economical Ranger™ 600 telephone, with features–including last-number redial and a memory dialer–that before were found only in high-priced phones, and new Nomad® cordless phones, which operate in the 46-49 MGz frequencies and offer improved sound quality, billing security and privacy.

We continued offering traditional telephones, including the Trimline® phone, our biggest seller, and we expanded our do-it-yourself wiring and accessories line to more than 50 products.

AT&T's consumer products can now be purchased at 7,000 outlets coast-to-coast, including department and discount stores, catalogue showrooms, and appliance and hardware stores–or by mail. They also are available at about 900 of our own AT&T Phone Centers, or by calling one of our 40 regional business offices toll-free, 1 800 555-8111.

Although many of our customers opted during the year to own their phones rather than to lease them as in the past, there continued to be a strong–and profitable–market for leased AT&T telephones. Many customers prefer the convenience and other advantages of leasing their phones. Still others are buying refurbished models of our basic sets, including the phones they previously leased.

One of the industry's fastest growing markets is cellular mobile communications, invented and developed by AT&T Bell Laboratories. It has been estimated that by the year 2000 one of every four or five vehicles in the United States will be equipped with a cellular phone.

Our Autoplex™ cellular telecommunications systems, provided by AT&T Network Systems, are used by cellular communications companies to transmit and route mobile calls. At year's end these systems were in use in 13 major cities. In addition to the systems themselves, we market three models of cellular phones, including a "hands-free" model.

We continued our pioneering role in interactive information management systems. Our computer-based Real Estate Information Service allows realtors and their customers to review on a television screen real estate listings and other information related to purchasing a home. Our new Videotex Information System offers all the hardware and software that

businesses need to operate a videotex system, which allows a customer to access data bases and retrieve information on a host of subjects.

As part of our effort to reduce costs and improve profit margins in the consumer telephone marketplace, we completed installation of an automated, programmable manufacturing facility at our plant in Shreveport, Louisiana.

We pursued business opportunities with the Federal government.

In 1984 we broadened the base of products and communications services sold to the Federal government.

We continued development of the new standard signal processor and began production of an advanced mobile sonar system to fulfill a $56 million contract with the U.S. Navy.

In the large command and control communications systems market, AT&T won a number of competitive bids, both domestically and abroad. One was a major award by the Defense Communications Agency to build an advanced network that will provide voice, data and video services to the U.S. Department of Defense and other Federal agencies. The contract is valued at nearly $900 million over 10 years.

We are installing a 350-mile lightwave system for the U.S. Army in Korea.

The components and electronic systems we produce "in-house" give our other lines of business significant advantages in the markets they serve.

Components and electronic systems represent a critical element in many AT&T products, such as computers, switching and transmission systems, and PBXs. To a great extent they determine the features, quality, reliability and cost of the products we offer.

We ensure our access to the most technically advanced components at reasonable cost by designing and producing them ourselves.

A worldwide silicon shortage in 1984 slowed the delivery of a number of our larger business systems. The shortage began to ease in midyear, although we continued to feel the effects of shortages of other components later into the year.

Major Developments

We announced that a computer memory chip that can store over one million bits of information–developed in less than a year by AT&T Bell Laboratories–will be ready for manufacture toward the end of 1985 and in full production the following year. With this announcement we signalled our intention to maintain our leadership in the field of electronic components. We expect to use this new megabit chip in such AT&T products as PBXs, digital switches and computers. It holds four times the amount of memory in about the same area of silicon as our 256K Random Access Memory chip, which we first fabricated in 1982 and which is now used in about two dozen AT&T products.

In 1984 we began using our new 32-bit microprocessor in our 3B computers and Teletype Corporation workstations. This is the most powerful 32-bit microprocessor available today.

We took steps during the year to increase our capacity to produce electronic components. We expanded integrated circuit production operations at three factories and opened a new facility in Orlando, Florida. We also are negotiating an agreement with Compania Telefonica Nacional de Espana to build a $200 million manufacturing facility to make integrated circuits in Spain.

Essential to most AT&T products are the printed wiring boards that link electronic components together. AT&T leads the world in printed wiring board technology. We also enjoy technological leadership in a wide range of other components, such as hybrid integrated circuits, relays, connectors and capacitors.

In addition to supporting our own internal needs for components, AT&T began in 1984 to sell selected electronic products in the commercial market.

We announced an agreement appointing Hamilton/Avnet as the first industrial electronics distributor for a range of high-performance AT&T component products, beginning with our 256K memory chip and our family of ODL™ lightwave data links.

The year also saw expanded marketing of power systems, which we develop and produce for our own products.

In producing high technology components and power systems, AT&T employs the most sophisticated manufacturing techniques and production processes. As part of a continuing effort to modernize and cut costs, we are phasing out our Hawthorne and Kearny works, transferring operations to more efficient facilities. Our printed circuit board plant in Richmond, Virginia, was singled out in a *Fortune* magazine article on "America's best-managed companies" as "the plant of the future, here and now."

We continued establishing footholds in international markets, developing offshore marketing and manufacturing channels for AT&T products and systems.

Our principal overseas presence is provided by AT&T International.

An agreement was reached with Ing. C. Olivetti & Co., S.p.A, which is 25 percent owned by AT&T, to market our 3B line of computers in Europe. And a new company was formed by AT&T and Olivetti–UNIX Europe–to handle licensing agreements and software distribution for the UNIX operating system.

In addition, AT&T International announced the opening in Tokyo of a UNIX systems office for the marketing, licensing and support of software products in the Far East.

AT&T Information Systems products were introduced in international markets in 1984. Systems 85 and 75 were made available in Canada for the first time. In Western Europe, System 85 was set for introduction in the United Kingdom and elsewhere.

We began marketing our 5ESS switch through the joint company we formed with N. V. Philips of the Netherlands–AT&T and Philips Telecommunications. This company will market both switching and transmission equipment in Europe, the Middle East and part of South America. Sales have been concluded in Colombia and the Netherlands.

A joint venture company was established with three Taiwan organizations to manufacture and market the 5ESS switch in Taiwan. We own 70 percent of this new company, AT&T Taiwan Telecommunications.

Another joint venture company, Gold Star Semiconductor, will also make the 5ESS switch and other switching products for sale in Korea.

To bolster our domestic production of lightwave fiber, we formed–with the Gold Star Cable Company of Korea–the Gold Star Fiber Optic Company. Production of optical fibers in Korea began in 1984.

Other activities in 1984.

A new subsidiary, AT&T Credit Corporation, was formed to provide long-term financing for customers purchasing equipment and services from AT&T units. By the end of 1985, AT&T Credit Corporation is expected to have assets of about $1 billion.

AT&T Resource Management was created at the time of divestiture. It was formed in part from our real estate division, the 195 Broadway Corporation. The company, which is responsible for developing all new office space for AT&T, seeks to derive maximum benefits from AT&T's investments in real estate and other capital assets. It owns or leases more than 23 million square feet of commercial space nationwide and has assets of approximately $1.25 billion.

Another subsidiary, American Transtech, manages shareowner services for AT&T and the seven regional companies formed from the Bell telephone companies at divestiture. These services include shareowner account recordkeeping, handling telephone and mail inquiries from shareowners, administering the dividend reinvestment plans, mailing dividend payments, and providing stock transfer and proxy-related services. The company also has undertaken some new ventures in direct marketing and data security services.

The principal philanthropic programs of AT&T and its subsidiaries are directed by the AT&T Foundation, which in 1984 made grants of some $16 million to higher education, health care, social action and cultural programs throughout the country. Its education program emphasizes university research and teaching important to the communications industry. An annual report is available by writing to: Secretary, AT&T Foundation, 550 Madison Avenue, Room 2400, New York, N.Y. 10022

Our commitment to equal opportunity and affirmative action is as strong in our new business environment as it was in the old. The representation of women and minorities in managerial positions provides a benchmark of past accomplishment as well as a base for future achievement. Approximately 32 percent of our managers are women and nearly 13 percent are minorities.

Of the year's many notable events, perhaps none will be better remembered by AT&T people than the 1984 Summer Olympics. We brought together and applied our most advanced Information Age technologies at the Games for the use of both participants and spectators. The systems we provided, including an advanced Electronic Messaging System, demonstrated AT&T's ability to design and provide large, complex, user-friendly information systems.

But in its own way, even more remarkable was the Olympic Torch Run, sponsored by AT&T Communications. For 82 days AT&T employees and others–aided by the Telephone Pioneers of America–carried the Olympic Torch over a 9,000-mile route that started in New York and ended at the site of the Olympic Games in Los Angeles. Some 30 million people turned out, at all hours of the day and night and in good weather and bad, to see the torch pass by and to cheer the runners with waving flags and patriotic songs. AT&T is proud to have been a part of this event. ■

Report of Management

The financial statements on pages 18 through 29, which consolidate the accounts of American Telephone and Telegraph Company and its subsidiaries, have been prepared in conformity with generally accepted accounting principles.

The integrity and objectivity of data in these financial statements, including estimates and judgments relating to matters not concluded by year-end, are the responsibility of management as is all other information included in the Annual Report unless indicated otherwise. To this end, management maintains a system of internal accounting controls which, on an ongoing basis, is reviewed and evaluated. Our internal auditors monitor compliance with it in connection with the annual plan of internal audits. Management believes that the Company's system provides reasonable assurance that transactions are executed in accordance with management's general or specific authorizations and are recorded properly to maintain accountability for assets and to permit the preparation of financial statements in conformity with generally accepted accounting principles. Management also believes that this system provides reasonable assurance that access to assets is permitted only in accordance with management's authorizations, that the recorded accountability for assets is compared with the existing assets at reasonable intervals, and that appropriate action is taken with respect to any differences. Management also seeks to assure the objectivity and integrity of its financial data by the careful selection of its managers, by organizational arrangements that provide an appropriate division of responsibility, and by communications programs aimed at assuring that its policies, standards, and managerial authorities are understood throughout the organization.

These financial statements have been examined by Coopers & Lybrand, independent Certified Public Accountants. The other auditors referred to in their report relating to years 1983 and 1982 are Arthur Young & Company, auditors of AT&T Technologies, Inc., (formerly Western Electric Company, Incorporated) and Southwestern Bell Telephone Company, and Arthur Andersen & Co., auditors of Illinois Bell Telephone Company.

The Audit Committee of the Board of Directors, which is composed of Directors who are not employees, meets periodically with management, the internal auditors, and the independent auditors to review the manner in which they are performing their responsibilities and to discuss auditing, internal accounting controls, and financial reporting matters. Both the internal auditors and the independent auditors periodically meet alone with the Audit Committee and have free access to the Audit Committee at any time.

Robert M. Kavner
Senior Vice President and Chief Financial Officer

Report of Independent Certified Public Accountants

We have examined the consolidated balance sheets of American Telephone and Telegraph Company and its subsidiaries as of December 31, 1984, January 1, 1984 and December 31, 1983 and the related consolidated statements of income and retained earnings and changes in financial position for the years ended December 31, 1984, 1983 and 1982. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements of two former telephone subsidiaries and AT&T Technologies, Inc. (formerly Western Electric Company, Incorporated) as of December 31, 1983 and 1982, were examined by other auditors; such statements reflect net income constituting approximately 25% of consolidated income before extraordinary charge for 1983, and 22% of consolidated net income for 1982. The reports of the other auditors have been furnished to us and our opinion expressed herein, insofar as it relates to amounts included for subsidiaries examined by them, is based solely on such reports.

As described in Notes (A) and (B) to Financial Statements, prior to 1984 the Company's financial statements included the accounts of 22 wholly-owned operating telephone companies. On January 1, 1984, as a result of a Court-ordered divestiture, certain operations of these companies were assigned to the Company and the companies were divested by a spin-off to shareowners. Due to the magnitude of the divested operations, the Company's financial statements for 1984 are not comparable to those of prior years.

In our opinion, based on our examinations, and the reports of other auditors for the years ended December 31, 1983 and 1982, the financial statements referred to above present fairly the consolidated financial position of American Telephone and Telegraph Company and its subsidiaries at December 31, 1984, January 1, 1984 and December 31, 1983, and the consolidated results of their operations and changes in their financial position for the years ended December 31, 1984, 1983 and 1982, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand
1251 Avenue of the Americas
New York, N.Y.

February 8, 1985

Results in Brief: Selected Financial Data

On January 1, 1984, AT&T was required by Court order to divest those parts of the Bell System operating telephone companies that provided local exchange and exchange access services and printed directory advertising. As a consequence of divestiture, 1984 financial results are not comparable to those of prior years. This change is discussed in Notes (A) and (B) to the financial statements.

Due to divestiture, 1984 financial results are not comparable to prior years.

DOLLARS IN MILLIONS (except per share amounts)	Post-divestiture 1984	Pre-divestiture 1983	1982	1981	1980
For the year:					
Total operating revenues	**$ 33,188**	$ 70,319	$ 65,866	$ 58,655	$ 51,152
Total operating expenses	**30,893**	57,338	50,678	44,365	38,728
Income before extraordinary charge	**1,370**	5,747	7,279	6,823	5,967
Extraordinary charge–net of taxes	**–**	(5,498)	–	–	–
Net Income	**1,370**	249	7,279	6,823	5,967
Preferred dividend requirements	**112**	127	142	146	150
Income applicable to common shares	**$ 1,258**	$ 122	$ 7,137	$ 6,677	$ 5,817
Earnings per common share	**$ 1.25**	$ .13	$ 8.40	$ 8.47	$ 8.04
Based on average shares outstanding (in millions)	**1,010**	937	850	788	724
Dividends declared per common share	**$ 1.20**	$ 5.85	$ 5.40	$ 5.40	$ 5.00
At end of year:					
Total assets	**$ 39,827**	$149,530	$148,186	$137,750	$125,553
Long-term debt including capital leases	**$ 8,718**	$ 44,810	$ 44,105	$ 43,877	$ 41,255
Preferred shares subject to mandatory redemption	**$ 1,494**	$ 1,523	$ 1,550	$ 1,563	$ 1,575
Convertible preferred shares subject to redemption	**–**	–	$ 301	$ 336	$ 385
Other statistics for 1984:					
Current ratio	**1.54**				
Capital expenditures	**$ 3,215**				
Return on average common equity	**9.48%**				

Market and Dividend Data

The principal market for trading in AT&T common stock is the New York Stock Exchange. The common stock is also listed in the United States on the Philadelphia, Boston, Midwest and Pacific exchanges. As of December 31, 1984, there were 3,197,905 holders of record of this common stock. Market data as obtained from the Composite Tape* and dividend data for the last two fiscal years are listed in the table at right. The payment of subsequent dividends by the Company will depend upon the earnings and financial requirements of the Company and other factors. The preferred shares rank prior to the common shares as to dividends. See Note (Q) to the financial statements.

The Company's stock price and dividends declared were significantly different in 1984 from previous years because of the change in the Company's size and other effects of divestiture. As a consequence of divestiture, investors who held AT&T shares on December 31, 1983 were entitled to receive one share in each of the newly formed regional holding companies for every ten shares of AT&T stock held. The combined percent increase in stock price of regional company and AT&T shares between December 30, 1983 and December 31, 1984, as measured by the Composite Tape, was 18.3%.

Calendar Quarter		Market Price* High	Low	Dividends Declared
1984	1st	$19¾	$15	$.30
	2nd	17⅜	14⅞	.30
	3rd	20¼	16⅝	.30
	4th	20	17¾	.30
1983	1st	$70¼	$59⅝	$1.80**
	2nd	69⅝	62⅛	1.35
	3rd	67⅞	60⅛	1.35
	4th	66⅜	60⅛	1.35

*Encompasses trading on the principal U.S. stock exchanges as well as off-board trading.

**A special one-time dividend of $.45 per common share was paid to holders of record on March 31, 1983. This special dividend was not a "dividend increase" but instead was a one-time payment declared by the Company to accommodate a change in the schedule of its regular quarterly dividend payments.

Management's Discussion and Analysis of Financial Condition and Results of Operations

As a result of divestiture on January 1, 1984, the former Bell System was separated into seven regional holding companies ("RHCs") and the "new" AT&T—a unified enterprise providing high quality, high technology products and services for information movement and management.

Because of the magnitude and nature of the changes which occurred at divestiture, comparison of financial results for 1984 with prior years is not meaningful; however, to provide a complete perspective of divestiture, this year's Annual Report for AT&T (the "Company") does include data for both 1984 and prior years. The impact of divestiture is further discussed in Note (B) to the financial statements. Because comparison of pre- and post-divestiture financial data is neither meaningful nor useful, we do not plan to issue pre-divestiture data in the future.

First Year Operating Results for the New AT&T

1984 was a year of change and major readjustment for AT&T as we moved through the difficult and abrupt transition from a stable, regulated, telephone company environment to the competitive world of advanced information technology. The rigors of this transition had a negative impact on the Company's operating results as did certain decisions by the Federal Communications Commission ("FCC"). Net income for the year was $1.4 billion, down substantially from management's expectations at the beginning of 1984, but the actions taken in 1984 have left the Company in a strong position for the future. In order to meet the demands of the new operating environment, the Company is continuing to streamline operations and reduce its cost structure, and has filed requests with the FCC for regulatory relief.

In November, 1983, as part of the preparations for divestiture, the Company issued an Information Statement and Prospectus ("IS&P") to inform investors of the changes about to occur and the expected impact on the Company's operations; included in the IS&P was a financial forecast for 1984. The following chart compares 1984 results with the IS&P forecast.

Three changes in financial reporting format have been made since the IS&P forecast was prepared and are reconciled in this chart by reclassifying IS&P data into the current format. An explanation of the reclassifications may be found in the notes following the chart.

Comparison of Statement of Income Line Items IS&P Forecast Format and Annual Report For Year 1984

DOLLARS IN BILLIONS (except per share amounts)		IS&P Forecast	Annual Report	Diff.
Total IS&P operating revenues		$56.5		
	(a)	(18.8)		
	(b)	1.0		
Total operating revenues		$38.7*	$33.2	$(5.5)
Total IS&P operating expenses		51.6		
	(a)	(18.8)		
	(b)	1.0		
	(c)	1.5		
Total operating expenses		35.3*	30.9	(4.4)
Net IS&P operating revenues		4.9		
	(c)	(1.5)		
Operating income		3.4*	2.3	(1.1)
Other income—net		.7	.5	(.2)
Interest expense		.7	.8	.1
Income before income taxes		3.4	2.0	(1.4)
IS&P operating taxes		2.8		
	(c)	(1.5)		
Provision for income taxes		1.3*	.6	(.7)
Net income		2.1	1.4	(.7)
Preferred dividend requirements		.1	.1	–
Income applicable to common shares		$ 2.0	$ 1.3	$ (.7)
Earnings per common share		$2.02	$1.25	$ (.77)
Weighted average number of shares outstanding (Millions)		989	1,010	21

**Adjusted for comparison*

Notes:

a) Telephone company access charges were reflected in the IS&P as an operating expense rather than as a reduction in revenue as they now appear in the Company's financial statements.

b) The provision for uncollectibles was shown in the IS&P as a reduction from revenue rather than as an operating expense as it is now classified.

c) Taxes not relating to income such as property, gross receipts and social security taxes were classified along with income taxes as operating taxes in the IS&P but are now included in the operating expenses category.

Revenues

Total operating revenues, net of access charges, were $33.2 billion in 1984, down $5.5 billion from our previous forecast expectations.

Revenues from sales of products, primarily those manufactured by AT&T Technologies, were less than expected because of increased competition, including a large influx of foreign manufactured products, and delays in the availability of key products due to silicon chip and other component shortages.

Service revenues, largely from long distance telecommunications services but also from installation and maintenance services and other special services, were also lower than expected. There were three principal factors in the service revenues shortfall: unexpectedly high charges paid to the local exchange carriers ("LECs") for access to their network (access charges), increased competition in the long distance calling market, and adverse regulatory actions which prevented the Company from earning a satisfactory return in most intrastate toll jurisdictions.

The increase in access charges paid to the LECs was partly due to the effect of an FCC mandated delay in instituting multiline business customer access charges, and a postponement until mid-1985 of residence customer and single line business customer access charges. As a result of these delays, the LECs charged higher access charges to the Company, charges which substantially exceeded Company estimates.

Rental revenues, principally from company-owned customer premises equipment, were approximately as expected.

Despite the negative influences on revenues in 1984, the Company expects to see significant increases in sales beginning in 1985. Marketplace demand for our high technology products is encouraging. In addition, component shortages are being resolved and plans have been laid for the introduction of new products in 1985. In sales of services, significant growth opportunities exist in international long distance calling and in special services such as private line and networking for large users. It is expected that competition in the long distance market will continue and become more intense, but we also expect that declines in market share will be offset by a growth in calling volumes, leading to an overall growth in our service revenues.

It now appears that net revenues from the sale of toll services would have shown a small but steady increase during 1984 if actual data rather than estimates had been available. Divestiture created a need for new systems and processes in the LECs to provide access charge billing as a replacement for the pre-divestiture division of revenues among the companies. In meeting these requirements, significant lags and problems occurred in the billing of actual amounts by the LECs during 1984, making it necessary for the Company to utilize estimates. Differences between these estimates and actual data subsequently reported were a source of concern to the Company throughout the year. As the year came to a close, the LECs had made significant progress in providing timely and accurate financial data and the Company had developed improved procedures to provide greater accuracy in situations where estimates are still required.

Expenses

Total operating expenses were $30.9 billion in 1984, down $4.4 billion from previous forecast expectations.

More than half the Company's total expense is the direct cost of services, products and rentals. The principal cause of the lower expenses in 1984 was lower than expected volumes. One-time increases did occur in some costs due to the introduction or expansion of a number of programs designed to reduce long-term costs.

As a part of our commitment to reduce costs, we are carrying out programs to phase out older factories, streamline production operations, and reduce inventories and expenses. Additionally, general and administrative costs are being reduced by eliminating redundancies and being more frugal.

Expenditures for research and development were $2.4 billion in 1984, reflecting the Company's continuing commitment to basic research, to new product design and development, and to the redesign and enhancement of existing products.

1984 also saw the settlement of numerous pending litigation cases, at a cost of $84.6 million, with payment of settlement amounts to be accomplished over a 15 year period. These costs were charged to expense in 1984 and will not impact income in future years. Settlement of these cases will enable the Company to concentrate more of its attention and resources on the present and future needs of the business.

Provision for income taxes of $581.5 million includes federal, state, local and foreign taxes on income. The difference between the effective income tax rate of 29.8 percent and the statutory federal income tax rate of 46.0 percent is attributable principally to the amortization of investment tax credits, state and local income taxes, and research credits.

Capital Expenditures

The Company's capital expenditures amounted to $3.2 billion in 1984 as we moved to take advantage of new market opportunities and to improve our products and services. Major areas of capital investment included network and special services growth and improvement, new customer equipment, and additions for development, production and billing operations. Internal sources provided financing for 95 percent of our total capital needs. Equity financing raised through the Company's Shareowner Dividend Reinvestment and Stock Purchase Plan, employee savings plans and capital leases provided the balance. We plan to continue making significant investments in productive assets that will enable us to take advantage of future opportunities.

Liquidity and Financing

As planned, the Company's cash and temporary cash investments decreased significantly during 1984, first by the $1.3 billion payment of the final dividend associated with the

former Bell System, then by the use of approximately $427.0 million to redeem maturing long-term debt, and approximately $445.6 million to reduce short-term debt outstanding. Cash and temporary cash investments were also affected by the assignment of assets between the Company and the Bell Operating Companies ("BOCs") at divestiture; in this asset assignment, essentially all receivables were left with the BOCs. As a result, the Company began the year with an unusually small amount of receivables and, as expected, had to draw from cash reserves to meet current obligations.

Our future plans for the management of cash call for maintaining a minimum amount of cash on hand to meet short-term needs and investing the remainder to provide growth opportunities for the business. Cash generated from operations will be used primarily to pay employees and suppliers for services rendered, to invest in the future business of AT&T, and to pay dividends to our stockholders. Consequently, cash and temporary cash investment balances are not expected to increase and may decline somewhat from the level at the end of 1984.

In other areas of current asset management, we are monitoring the levels of receivables and inventories and will institute additional management procedures where needed.

Equity financing during 1984 totaled $1,228.2 million from new common equity, of which $740.8 million was raised through the Company's Shareowner Dividend Reinvestment and Stock Purchase Plan, $445.6 million through employee savings plans and $41.8 million through the Employee Stock Ownership Plan. This increase in common equity was partially offset by the redemption of 12,500 shares of $77.50 preferred shares totaling $12.5 million and redemptions of 300,000 shares of $3.64 preferred and 300,000 shares of $3.74 preferred totaling $16.1 million, in accordance with sinking fund provisions.

Debt outstanding decreased by $701.5 million between January 1 and December 31, 1984. Long-term debt decreased $255.9 million due to retirement of the Company's $250.0 million of 3¼% debentures due September 15, 1984; retirement of $150.0 million of The Pacific Telephone and Telegraph Company ("Pacific") 9.1% debentures due October 15, 1984 assumed at divestiture; and by the retirement of other long-term debt of $27.0 million which was offset by an increase in other long-term debt of $171.1 million. In addition to the above debt retirements, the Company has announced plans to call $300.0 million of debt, also assumed from Pacific at divestiture, during 1985; see Note (N) to the financial statements. Short-term debt decreased $445.6 million resulting from decreases in commercial paper of $405.8 million and in bank loans and other notes of $39.8 million.

The Company's debt ratio decreased from 42.5 percent as of January 1, 1984 to 38.5 percent as of December 31, 1984 as a result of the increase in equity financing and the decrease in debt financing. If preferred shares subject to mandatory redemption were included with debt, the debt ratio would have been 48.8 percent and 44.6 percent at January 1 and December 31, 1984, respectively.

We expect over time to bring our debt ratio down to a range of 25 to 30 percent.

Dividends declared payable to common shareowners in 1984 were $1.20 per common share. This payout represented 97 percent of Income Applicable to Common Shares. Further details relating to market and dividend data may be found on page 14.

The impact of inflation on the Company's results and financial position in 1984 is discussed in the Supplementary Data section beginning on page 30.

Summary of Prior Bell System Results

Because operating results and financial position for 1984 are not comparable to previous years, the following summary of 1983 and 1982 results is presented for general information only.

Operating Results—In the former Bell System, revenues grew throughout 1982 and 1983, but at a slower rate in 1983 due to increased long distance telecommunications competition. Expenses continued to show the impact of inflation, which was primarily reflected in increases in salary and wage related costs, in research and systems engineering costs, and in other operating and administrative costs. Expenses increased both in 1983 and 1982, although at a lesser rate in 1983.

AT&T Technologies, Inc.'s net income declined sharply during 1983 and 1982, principally due to diminished sales volumes and to costs associated with reorganization and consolidation of manufacturing, distribution and repair facilities.

Financing—AT&T obtained approximately 84 percent of its capital needs through internal sources in 1983 and 87 percent in 1982. The Company's debt ratio (debt as a percent of total debt, common equity, and preferred shares) was 42.9 percent at year end 1983 and 42.3 percent at year end 1982.

In Conclusion

1984 has been a year of reorganization and a new financial beginning for AT&T. To operate in a new world of competitive information technology, we are cutting costs, investing in new technology, continuing to strengthen our balance sheet, introducing new accounting and management procedures, and laying out solid financial plans for the future.

We look forward to 1985 as a year of growth in which we will begin to reap the benefits of these efforts.

American Telephone and Telegraph Company and its Subsidiaries
Years ended December 31, 1984, 1983 and 1982

Consolidated Statements of Income and Retained Earnings

Due to divestiture, 1984 financial results are not comparable to prior years.

DOLLARS IN MILLIONS (except per share amounts)	**Post-divestiture 1984(B)**	Pre-divestiture 1983	1982
SALES AND REVENUES			
Sales of services, net of access charges of $20,633.0	**$15,780.8**		
Sales of products	**10,189.4**		
Rental revenues	**7,217.3**		
Total operating revenues (C)	**33,187.5**	$70,319.0	$65,866.4
COSTS AND EXPENSES			
Cost of services	**8,010.3**		
Cost of products	**6,166.8**		
Cost of rentals	**2,574.2**		
Selling, general and administrative, and other expenses (D)	**14,142.0**		
Total operating expenses (C)(D)(G)(H)	**30,893.3**	57,338.3	50,677.8
OPERATING INCOME	**2,294.2**	12,980.7	15,188.6
Other income–net (E)	**524.5**	300.8	376.8
Interest expense (F)	**867.3**	3,950.4	3,612.4
Income before income taxes	**1,951.4**	9,331.1	11,953.0
Provision for income taxes (I)	**581.5**	3,584.5	4,961.0
Income before extraordinary charge and cumulative effect of a change in accounting principle	**1,369.9**	5,746.6	6,992.0
Extraordinary charge–net of taxes (B)	**–**	(5,497.9)	–
Prior years' cumulative effect (through December 31, 1981) of the change in accounting for deferred income taxes in 1982 (I)	**–**	–	286.8
NET INCOME	**1,369.9**	248.7	7,278.8
Preferred dividend requirements	**112.3**	126.5	141.9
INCOME APPLICABLE TO COMMON SHARES (carried forward)	**$ 1,257.6**	$ 122.2	$ 7,136.9

The accompanying notes are an integral part of the financial statements.

Due to divestiture, 1984 financial results are not comparable to prior years.

DOLLARS IN MILLIONS (except per share amounts)	**Post-divestiture 1984(B)**	Pre-divestiture 1983	1982
INCOME APPLICABLE TO COMMON SHARES (brought forward)	**$1,257.6**	$ 122.2	$ 7,136.9
EARNINGS PER COMMON SHARE AMOUNTS based on weighted average number of shares outstanding of 1,009,569,000 in 1984, 936,801,000 in 1983, and 849,550,000 in 1982.			
Before extraordinary charge and cumulative effect of a change in accounting principle	**$ 1.25**	$ 6.00	$ 8.06
Extraordinary charge (B)	**–**	(5.87)	–
Prior years' cumulative effect (through December 31, 1981) of the change in accounting for deferred income taxes in 1982 (I)	**–**	–	.34
Earnings per Common Share	**$ 1.25**	$ .13	$ 8.40
RETAINED EARNINGS			
At beginning of year	**$4,803.9***	$28,888.5	$26,364.9
Add: Net income	**1,369.9**	248.7	7,278.8
Miscellaneous–net (S)	**41.9**	(7.8)	(12.6)
	6,215.7	29,129.4	33,631.1
Deduct dividends declared:			
Convertible preferred shares subject to redemption:			
$4 Cumulative convertible preferred shares	**–**	11.6	25.2
Preferred shares subject to mandatory redemption:			
$3.64 Preferred shares	**34.7**	35.9	36.4
$3.74 Preferred shares	**36.9**	37.4	37.4
$77.50 Preferred shares	**40.7**	41.7	42.6
Common: 1984, $1.20 per share; 1983, $5.85 per share and 1982, $5.40 per share	**1,221.5**	5,495.9	4,601.0
	1,333.8	5,622.5	4,742.6
At end of year	**$4,881.9**	$23,506.9*	$28,888.5

*Following the close of 1983, the pre-divestiture retained earnings balance of $23,506.9 was reduced by $18,703.0 of divestiture adjustments, resulting in a $4,803.9 opening retained earnings balance for the "new" AT&T at January 1, 1984. This change is discussed in Note (B) to the financial statements.

Consolidated Balance Sheets

Due to divestiture, 1984 financial results are not comparable to prior years.

DOLLARS IN MILLIONS (except per share amounts)	Post-divestiture at Dec. 31, 1984(B)	Post-divestiture at Jan. 1, 1984(B)	Pre-divestiture at Dec. 31, 1983
ASSETS			
CURRENT ASSETS			
Cash and temporary cash investments	$ 2,139.9	$ 5,311.7	$ 4,775.1
Receivables less allowance for uncollectibles: $318.4, $194.4 and $358.8, respectively	9,370.8	4,257.2	9,730.9
Inventories (J)	4,789.2	3,616.5	1,436.3
Deferred income taxes	751.4	606.3	331.6
Other current assets	281.7	554.9	342.6
Total current assets	17,333.0	14,346.6	16,616.5
Investments (M)	421.7	333.9	6,146.3
Property, plant and equipment–net (B)(K)(L)	21,015.0	20,289.3	123,754.2
Other assets	1,056.9	622.0	3,012.8
TOTAL ASSETS	$39,826.6	$35,591.8	$149,529.8
LIABILITIES AND SHAREOWNERS' EQUITY			
CURRENT LIABILITIES			
Accounts payable	$ 5,580.3	$ 2,326.0	$ 6,860.9
Accrued vacation compensation	1,024.8	975.1	818.0
Debt maturing within one year (N)	850.1	1,126.4	2,307.5
Advance billing and customers' deposits	537.1	302.3	1,729.7
Dividends payable	339.2	1,332.3	1,335.8
Interest accrued	259.2	199.6	1,159.2
Other current liabilities	2,652.9	2,151.3	1,657.6
Total current liabilities	11,243.6	8,413.0	15,868.7
DEFERRED CREDITS			
Deferred income taxes	2,000.7	953.9	16,366.0
Unamortized investment tax credits	1,725.4	1,700.4	8,059.3
Other deferred credits	299.9	346.4	1,629.7
Total deferred credits	4,026.0	3,000.7	26,055.0
Long-term debt including capital leases (B)(O)(L)	8,717.5	9,137.1	44,810.3
Other long-term liabilities	582.7	1,151.1	–
Commitments and contingencies (U)	–	–	–
Ownership interest of others in consolidated subsidiaries	–	–	510.9
Preferred shares subject to mandatory redemption (Q)	1,493.9	1,522.5	1,522.5
COMMON SHAREOWNERS' EQUITY			
Common shares–par value $1 per share (R)	1,037.7	965.7	965.7
Authorized shares: 1,200,000,000			
Outstanding shares: 1,037,678,000 at Dec. 31, 1984; 965,731,000 at Jan. 1, 1984 and Dec. 31, 1983			
Additional paid-in capital (R)	7,843.3	6,597.8	36,289.8
Retained earnings (B)	4,881.9	4,803.9	23,506.9
Total common shareowners' equity	13,762.9	12,367.4	60,762.4
TOTAL LIABILITIES AND SHAREOWNERS' EQUITY	$39,826.6	$35,591.8	$149,529.8

The accompanying notes are an integral part of the financial statements.

American Telephone and Telegraph Company and its Subsidiaries
Years ended December 31, 1984, 1983 and 1982

Consolidated Statements of Changes in Financial Position

Due to divestiture, 1984 financial results are not comparable to prior years.

DOLLARS IN MILLIONS (except per share amounts)	**Post-divestiture 1984†***	Pre-divestiture 1983*	1982*
Funds (cash and temporary cash investments) at January 1	**$ 5,311.7**	$ 2,453.7	$ 1,262.6
SOURCES OF FUNDS			
From operations:			
Net Income	**1,369.9**	5,746.6	6,992.0
Depreciation	**2,777.9**	9,854.2	8,734.5
Deferred income taxes–net	**777.3**	2,400.7	4,167.7
Other	**(31.6)**	625.4	1,271.9
Funds from operations before extraordinary charge and cumulative effect of a change in accounting principle	**4,893.5**	18,626.9	21,166.1
Extraordinary charge	**–**	(5,497.9)	–
Cumulative effect of a change in accounting principle	**–**	–	286.8
Extraordinary charge not requiring funds currently	**–**	4,869.9	–
Cumulative effect of a change in accounting principle not providing funds currently	**–**	–	(286.8)
Total funds from operations	**4,893.5**	17,998.9	21,166.1
From external sources:			
Increase in long-term debt	**171.1**	1,359.3	713.4
Issuance of shares, net of redemptions	**1,195.6**	3,902.1	4,463.4
Other–divestiture cash flow settlement (S)	**175.1**	–	–
Total funds from external sources	**1,541.8**	5,261.4	5,176.8
Total funds available	**11,747.0**	25,714.0	27,605.5
USES OF FUNDS			
Retirement of long-term debt	**427.0**	557.1	785.0
Dividends paid	**2,326.9**	5,516.7	4,687.2
Decrease in short-term borrowings–net	**445.6**	807.5	674.1
Investment in property, plant and equipment–net (S)	**3,462.1**	14,849.3	16,814.4
Increase in investments	**67.9**	600.0	72.3
Net change in working capital, detailed below	**1,913.1**	(1,292.2)	1,259.2
Increase in other assets	**435.5**	1,074.6	541.1
Other–net	**529.0**	(1,174.1)	318.5
Total uses of funds	**9,607.1**	20,938.9	25,151.8
Funds (cash and temporary cash investments) at December 31	**$2,139.9**	$ 4,775.1	$ 2,453.7

Working capital components (excluding cash and temporary cash investments, debt maturing within one year, dividends payable and deferred income taxes)			
Increase (decrease) in net receivables	**$ 5,113.6**	$ 1,151.4	$ 748.3
Increase (decrease) in inventories	**1,172.7**	257.5	7.2
Increase (decrease) in other current assets	**(273.2)**	96.8	19.2
(Increase) decrease in accounts payable	**(3,254.3)**	(2,592.7)	(754.8)
(Increase) decrease in other current liabilities	**(845.7)**	(205.2)	1,239.3
Net change in working capital	**$ 1,913.1**	$ (1,292.2)	$ 1,259.2

The accompanying notes are an integral part of the financial statements.

†The 1984 statement reflects changes from January 1, 1984 to December 31, 1984. *This statement has been changed from the "funds supporting construction" format commonly used by regulated utilities to the "funds flow" format prepared on a cash and temporary cash investments basis. Prior years have been restated to conform to the 1984 presentation format.

Notes to Financial Statements

DOLLARS IN MILLIONS (except per share amounts)

(A) Summary of Major Accounting Policies

General Change in Accounting and Reporting Practices–Prior to 1984, the Company's financial statements reflected accounting practices applicable to regulated public utilities for its tariffed telecommunications services as well as accounting principles appropriate for nonregulated entities for the remainder of the Company. Divestiture and the growth of competition in the telecommunications business have significantly changed the environment in which the Company operates. Accordingly, at the close of 1983 the Company adjusted its financial statements to reflect the discontinuance of accounting practices appropriate for rate-regulated enterprises. See Note (B). As a result, the reporting of Company financial data for 1984 is consistent with generally accepted accounting principles for nonregulated enterprises.

Consolidation–The 1984 consolidated financial statements include the accounts of the Company and all its significant wholly-owned subsidiaries. As a result of divestiture and the change in the nature of the Company's business, the consolidation now includes AT&T Technologies, Inc. (formerly Western Electric Company, Incorporated) and AT&T Bell Laboratories, Incorporated ("AT&T Bell Labs"), formerly Bell Telephone Laboratories, Incorporated, which were reported as investments on an equity basis prior to 1984. Investments in 20 percent to 50 percent-owned companies and joint ventures are carried on the equity method. Other investments are recorded at cost.

For years prior to 1984, the Company's consolidated financial statements included the accounts of 22 wholly-owned Bell operating telephone companies ("BOCs"). On January 1, 1984, under Court order, these companies were divested and are no longer affiliated with the Company.

Industry Segmentation–The Company operates as a unified and vertically integrated enterprise in the rapidly evolving industry segment, information movement and management. This industry encompasses all facets of information and communications technology, including the development and provision of devices which receive, send, or process information, the provision of facilities and services which move information over wires and other circuits, and the provision of services which provide customer support in the usage of information technology.

Regulatory requirements presently impose some structural separation in the Company's operations and organization; however, the Company has filed requests to remove these restrictions in order to further integrate its operations.

Revenue Refunds–Beginning in 1984, liabilities for probable revenue refunds, if any, are reflected in current year results, rather than by restating the results of the prior periods during which the related revenues were originally recorded.

Plant and Equipment–The investment in plant and equipment is stated at original cost. Prior to 1984, such cost for rate-regulated telephone plant and equipment included intercompany profits. Commencing in 1984, the original cost of all newly-acquired plant and equipment excludes intercompany profits. In some instances the cost of plant previously purchased in the Company's pre-divestiture operations as a regulated telephone utility has been reduced to the amount expected to be recoverable in a competitive environment. See Note (B).

Depreciation–Depreciation is calculated principally using the group straight-line method over the useful lives of assets. When depreciable plant is retired, the amount at which such plant has been carried in plant in service is charged to accumulated depreciation. AT&T Technologies, Inc. provides for depreciation on a group straight-line basis for composite accounts of assets acquired prior to January 1, 1980 and on an accelerated method for composite accounts of assets placed in service subsequent to December 31, 1979.

Long-term Contracts–Long-term contracts are accounted for generally on the percentage-of-completion basis.

Inventories–Inventories are stated at the lower of cost, principally determined on a first-in, first-out ("FIFO") basis, or market, with provision for loss for defective material and obsolescence.

Retirement Plans–All costs are accrued over the active working lives of the employee work force. See also Note (G).

Income Taxes–Income tax expense includes the effects of timing differences between reported earnings and taxable earnings. These differences arise when certain transactions are included in the financial statements in years different from those in which they are reported for income tax purposes.

Investment tax credits are deferred and amortized as a reduction in income tax expense over the average useful life of the applicable classes of property.

The Company's tax liability also is reduced as a result of a tax credit relating to the Employee Stock Ownership Plan ("ESOP"), the amount of which is contributed to the ESOP, and by a tax credit relating to research activities.

(B) Impact of Divestiture

As a result of the Court-ordered January 1, 1984 divestiture, the Company's integrated telecommunications business was split up with those portions which operate predominantly under monopoly regulation, the BOCs, being assigned to seven regional holding companies ("RHCs") and those portions which face strong and growing competition being assigned to the post-divestiture AT&T. Consequently, certain of the Company's accounting policies and practices were no longer appropriate after December 31, 1983. Accordingly, the Company adjusted its financial statements on December 31, 1983 to reflect the discontinued use by the post-divestiture AT&T of accounting policies and practices appropriate for rate-regulated enterprises and restated the rate-regulated assets assigned to the new AT&T on a basis appropriate for nonregulated enterprises.

These adjustments, each of which reduced the carrying value of the post-divestiture AT&T's net assets, consisted of the following:

(1) Reducing the carrying value of terminal equipment and network facilities from the amounts recognized by regulators in the rate-making process to a lesser amount expected to be recoverable in a competitive environment.

(2) Establishing liability accruals for expenses which in the rate-making process have been accounted for only when paid. These include expenses for future compensated absences and special termination benefits.

(3) Establishing deferred income tax credits for tax timing differences which regulators in the rate-making process have recognized on a current basis rather than on a deferred basis as is required for nonregulated businesses.

These adjustments were accounted for as a divestiture-related extraordinary charge on December 31, 1983, reducing Income Applicable to Common Shares by $5.5 billion, net of taxes of $4.5 billion (comprised of $.1 billion of current taxes and $4.4 billion of deferred taxes), or $5.87 per share.

Additional accounting changes were made in 1984 that did not require adjustments to income in 1983; the changes relating to Consolidation, Revenue Refunds, and Plant and Equipment are discussed in Note (A), Summary of Major Accounting Policies. In addition, the asset values and related obligations of capital leases are included in the 1984 balance sheets. The amortization of assets under capital leases and the interest cost of capital lease obligations are included in current results.

In addition to the divestiture impacts described above, the Divestiture Plan of Reorganization required AT&T and the BOCs to discontinue joint ownership of facilities which perform multiple communications functions. Appropriate arrangements have been made through operating leases and service agreements to utilize these facilities.

1983 expenses included costs of FCC and divestiture-related reorganization plans. These charges, incurred in connection with new entities and with employee relocations and reductions, amounted to $937.0, net of taxes.

Due to the magnitude of divestiture and the nature of the organizational and accounting changes related thereto, the Company's results for 1984 are not comparable to those of prior years. The new, post-divestiture AT&T is about one-fourth the size of the pre-divestiture enterprise for which 1983 and 1982 results are included in these financial statements. Furthermore, divestiture involved an intricate reassignment of business operations, assets and liabilities, and employees. The pervasive and complex nature of these changes makes it impossible to restate pre-divestiture results in a way which would be comparable to post-divestiture results.

The January 1, 1984 balance sheet reflects the accounts of the post-divestiture AT&T. Included are the assets and liabilities transferred from the BOCs at net book value. Also reflected is the consolidation of AT&T Technologies, Inc. and AT&T Bell Labs. Reclassifications of account categories have been made to conform to classifications in effect at year end 1984. The net effect of divestiture adjustments reduced retained earnings at December 31, 1983 by $18,703.0.

(C) Operating Revenues and Expenses for Prior Years

Pre-divestiture operating revenues and expenses were as follows:

	1983	1982
Operating revenues		
Local services	$30,274.5	$28,986.3
Toll services	34,528.7	33,256.4
Directory advertising and miscellaneous	5,515.8	3,623.7
Total operating revenues*	$70,319.0	$65,866.4
Operating expenses		
Depreciation	$ 9,854.2	$ 8,734.5
Other operating expenses (including taxes not related to income and provision for uncollectibles)*	47,484.1	41,943.3
Total operating expenses*	$57,338.3	$50,677.8

*Reclassified to conform to 1984 presentation.

DOLLARS IN MILLIONS (except per share amounts)

(D) Research and Development

Research and development expenditures, which are charged to expense as incurred, amounted to $2,368.1 in 1984, $862.2 in 1983 and $610.6 in 1982, respectively. The 1983 and 1982 research and development expenditures of AT&T Technologies, Inc., which were $1,358.9 and $1,179.8, respectively, are not included in the above amounts because AT&T Technologies, Inc., was not consolidated prior to 1984. See Note (A).

(E) Other Income

Other Income–net for the years 1984, 1983 and 1982 includes the net income applicable to investments in unconsolidated companies (including AT&T Technologies, Inc. in 1983 and 1982) accounted for on an equity basis of $19.9, $54.3 and $372.3, respectively, and interest income, primarily from temporary cash investments, of $452.3, $493.4 and $234.8, respectively. Also included in other income are gains relating to the sale of fixed assets, dividend income, and other miscellaneous income. Deductions from other income relate principally to contributions and other miscellaneous non-operating expenses and also, in 1983 and 1982, minority ownership of others in net income.

(F) Interest Capitalized

Interest expense is net of interest capitalized, which was $74.7, $356.8, and $317.6 in 1984, 1983 and 1982, respectively.

(G) Provisions for Pensions and Death Benefits

Prior to 1984, employees of the pre-divestiture Bell System were covered by two pension plans, one for non-management employees and the other for management employees. As a result of divestiture, the non-management and management pension plans were split into several non-management and management pension plans covering the divested companies and the new AT&T.

Contributions to the pension plans are made to irrevocable trust funds. It has been, and continues to be, the policy of the Company to make contributions which are equal to the current year cost of the plans determined on a going concern basis by an actuarial method specified by the Employee Retirement Income Security Act of 1974 ("ERISA"). The actuarial cost method used for pension cost determination by the Company is the Aggregate Cost Method.

The following data provide information on plan costs. Figures for years 1983 and 1982 relate to the entire pre-divestiture Bell System whereas figures for 1984 are for the new AT&T and its subsidiaries only.

	1984	1983	1982
Current year cost	**$1,043.4**	$2,620.2	$3,510.7
Current year cost as a percent of salaries and wages	**9.0%**	9.2%	12.8%

The 1984 current year cost was determined using an assumed investment earnings rate which varies by calendar year. The rates assumed are 8% for 1984 and 1985 and decline to 5% by 1998, remaining at 5% thereafter. If the assumed investment earnings rates were 1% lower, the 1984 current year cost would be $497.0 more than shown above.

The reduction in the dollar amount of pension costs from 1983 to 1984 is due primarily to the smaller employee base of the post-divestiture AT&T. 1983 pension costs decreased by approximately $959.1 due to a change in the assumed earnings rate in 1983. Amendments to the plans in 1983 had the effect of increasing costs by approximately $61.5 and $270.7, in 1984 and 1983, respectively.

Statement of Financial Accounting Standards No. 36 ("Statement No. 36") requires disclosure to be made of the actuarial present value of accumulated plan benefits and the fair value (essentially current market value) of net assets available for plan benefits. The following data are based on the latest actuarial valuations. Figures for the post-divestiture AT&T are on an estimated basis.

	January 1, 1984	December 31, 1983	December 31, 1982
Actuarial present value of accumulated plan benefits:			
Vested	**$ 9,600.9**	$31,568.6	$26,161.3
Non-Vested	**1,832.0**	4,520.2	3,939.5
Total	**$11,432.9**	$36,088.8	$30,100.8
Fair value of net assets available for plan benefits	**$17,148.3**	$53,957.0	$46,380.3

The rates of return used in determining the actuarial present value of accumulated plan benefits are the rates used by the Pension Benefit Guaranty Corporation ("PBGC") for determining the value of plan benefits under terminated pension plans and averaged approximately 9.1% and 9.9% compounded annually at December 31, 1983 and 1982, respectively. If the rates used by PBGC had been 1% lower, the actuarial present value of accumulated plan benefits at December 31, 1983 would have been approximately $40,646.9 instead of $36,088.8 as shown above for pre-divestiture AT&T and $13,021.4 instead of $11,432.9 as shown above for post-divestiture AT&T at January 1, 1984.

The Company believes that misleading inferences concerning the plans' funding status may result from a comparison of the actuarial present value of accumulated plan benefits with the fair value of net assets available for plan benefits. This is because plan assets have been accumulated by making contributions equal to current year costs determined on a going concern basis as required by ERISA, while the determination of the actuarial present value of accumulated plan benefits required by Statement No. 36 is essentially a "plan termination" type calculation which uses methods and assumptions which are not the same as those used to determine current year pension costs. Furthermore, the fair value of net assets available for plan benefits will fluctuate which also may create erroneous impressions with respect to long-term progress on funding the pension plans.

(H) Post-Retirement Health Care and Life Insurance Benefits

The Company provides health care benefits for retired employees through insurance company contracts in which the premiums are based on benefits paid plus administrative expenses. The Company recognizes the cost of providing such benefits by expensing the annual insurance premiums, which were $853.6 for 1984. This cost, which is not separable by active and retired employees, represented 7.4% of total salaries and wages and included costs for approximately 365,000 active and 70,000 retired employees.

Under the terms of the Divestiture Plan of Reorganization, AT&T is responsible for a portion of the health care benefits costs of the divested BOCs' pre-divestiture retirees. Such cost is expensed as incurred and totaled $92.0 for 1984.

The Company also provides life insurance benefits for all retired employees. The current year cost, determined using the Aggregate Cost actuarial method, was $36.3 for 1984, representing less than one percent of total salaries and wages.

(I) Income Taxes

The components of income tax expense are as follows:

	1984	1983	1982
Current			
Federal	**$(241.6)**	$261.3	$(775.6)
Foreign	**8.6**	6.8	(2.9)
State and local	**14.5**	337.4	311.3
Deferred			
Federal	**682.2**	2,245.9	3,984.5
Foreign	**–**	(1.5)	–
State and local	**95.1**	164.6	219.8
Deferred investment tax credits–net	**9.2**	440.9	1,089.4
ESOP tax credit	**13.5**	129.1	134.5
Total	**$581.5**	$3,584.5	$4,961.0

Deferred income tax expense results primarily from timing differences between tax and financial reporting of depreciation expense and also, in 1984, from sales-type leases and special termination benefits.

The Company's Current Federal Income Taxes are negative in 1984 due to a net operating loss for tax purposes and research credits. Carryback of these items will result in refunds of income taxes paid in prior years.

Investment tax credits are net of amortization of $309.2 in 1984, $725.7 in 1983 and $795.5 in 1982.

In 1982, the Company changed its accounting for certain deferred income taxes (primarily state and local) to eliminate deferred taxes not recognized by regulators having jurisdiction over the related plant. This change increased net income in 1982 by $352.7 ($.42 per share), including the prior years' cumulative effect of $286.8 ($.34 per share).

1982 Current and Deferred Income Taxes were also affected by settlement of a tax matter relating to The Pacific Telephone and Telegraph Company's ("Pacific") eligibility for accelerated tax depreciation and investment tax credit. This change increased net income in 1982 by $191.2 ($.22 per share), including $47.8 ($.06 per share) applicable to prior years. In 1983, further settlements between the Company and Pacific and the IRS on this same matter increased net income by $216.4 ($.23 per share).

A reconciliation between the statutory federal income tax rate and the effective income tax rate is as follows:

	1984	1983	1982
Statutory federal income tax rate	**46.0%**	46.0%	46.0%
State and local income taxes, net of federal income tax effect	**3.1**	2.9	2.4
Amortization of investment tax credits	**(15.8)**	(7.8)	(5.3)
Research credits	**(3.2)**	(.6)	(.2)
Plant construction costs deducted for tax purposes, depreciated for book purposes	**–**	(1.5)	(2.0)
Settlement of Pacific's prior years' tax matters	**–**	(2.3)	1.3
Other differences	**(.3)**	1.7	(.7)
Effective income tax rate	**29.8%**	38.4%	41.5%

(J) Inventories

At lower of cost or market:

	December 31, 1984	January 1, 1984
Completed	**$1,875.8**	**$1,244.1**
In process	**1,999.4**	**1,573.9**
Raw materials and supplies	**914.0**	**798.5**
Total inventories	**$4,789.2**	**$3,616.5**

Inventories in 1984 included new equipment held for sale, lease or maintenance, used rental equipment held for reuse or sale, items in the process of manufacture, and materials and supplies.

Inventories at December 31, 1983 were $1,436.3 and consisted primarily of materials and supplies in the BOCs and new customer premises equipment held for sale, lease or maintenance. The amount for 1983 does not include $3,120.6 of inventory of AT&T Technologies, Inc. which was not consolidated prior to 1984. See Note (A).

(K) Property, Plant and Equipment

At cost:

	December 31, 1984	January 1, 1984	December 31, 1983
Land	**$ 452.6**	**$ 432.9**	$ 913.8
Buildings and leasehold improvements	**5,648.8**	**5,179.3**	14,412.4
Machinery and electronic equipment	**30,046.7**	**30,686.5**	138,877.7
Transportation equipment, furniture, tools and other	**2,359.7**	**2,292.8**	12,690.1
Total property, plant and equipment	**38,507.8**	**38,591.5**	166,894.0
Less: Accumulated depreciation	**17,492.8**	**18,302.2**	43,139.8
Net property, plant and equipment	**$21,015.0**	**$20,289.3**	$123,754.2

DOLLARS IN MILLIONS (except per share amounts)

Depreciation expense was $2,777.9, $9,854.2 and $8,734.5 for 1984, 1983 and 1982, respectively.

(L) Leases

The Company's future minimum lease payments under capital and non-cancellable operating leases, together with the present value of the net minimum capital lease payments at December 31, 1984, are as follows:

	Capital Leases	Operating Leases
Minimum lease payments for years ending December 31:		
1985	**$ 163.6**	**$ 546.5**
1986	**136.6**	**460.1**
1987	**95.4**	**353.4**
1988	**46.7**	**286.0**
1989	**17.8**	**146.6**
Remainder	**164.2**	**539.4**
Total minimum lease payments	**$ 624.3**	**$2,332.0**
Less: Estimated executory costs on capital leases	**24.1**	
Imputed interest on capital leases	**219.5**	
Present value of net minimum capital lease payments	**$ 380.7**	

Rental expense under operating leases was $855.9 in 1984, $1,768.2 in 1983 and $1,508.4 in 1982.

Prior to 1984, under accounting appropriate for regulated industries, all leases of the Company's regulated entities were reflected in financial statements as operating leases.

In addition to leasing property from others for use in the business, the Company also leases its products to customers. The Company's net investment in sales-type leases at December 31, 1984, was $521.6.

The Company also leases equipment to others on an operating lease basis; the principal portion of these leases is cancellable. The net investment for such equipment at December 31, 1984 was as follows:

Machinery and equipment	**$8,831.3**
Less: Accumulated depreciation	**5,784.6**
Net investment	**$3,046.7**

The minimum future rental payments to be received on leases are as follows:

	Sales-Type Leases	Operating Leases
1985	**$256.3**	**$105.1**
1986	**254.8**	**48.2**
1987	**197.3**	**23.7**
1988	**104.8**	**10.1**
1989	**51.3**	**.4**
Thereafter	**13.7**	**.1**
Total	**$878.2**	**$187.6**

(M) Investments at Equity

As of December 31, 1984 the Company held the following major equity investments:

Ing. C. Olivetti & Co., S.p.A. –25.0% of voting shares owned, an international manufacturer and marketer of office equipment and communications products. The Company's investment at equity is $252.5.

Joint venture with N.V. Philips–50.0% of voting shares owned, to explore and develop international opportunities for marketing and distribution of Company products and services. The Company's investment at equity is $86.1.

Dividends received from equity investment entities were $2.7 in 1984. The Company's cumulative equity investment in undistributed earnings of investees was $30.0 at December 31, 1984. See also Note (E).

During 1983 and 1982 the Company also held major equity investments in AT&T Technologies, Inc., AT&T Bell Labs, The Southern New England Telephone Company ("SNET") and Cincinnati Bell Inc. AT&T Technologies, Inc. and AT&T Bell Labs are now consolidated in the Company's financial statements. Investment in SNET has been sold while the investment in Cincinnati Bell Inc. is now recorded at the amount which will be realized upon completion of the sale to that company.

The following summarized consolidated financial information is for AT&T Technologies, Inc. in years 1983 and 1982:

	1983	1982
Sales	$11,154.7	$12,579.9
Operating costs and expenses	10,841.5	11,359.5
Provision related to Facility Utilization Plans	260.0	625.0
Net Income	50.7	336.7
Current assets	$5,426.1	$4,770.7
Net plant and equipment	3,152.6	2,936.8
Other assets	508.8	490.3
Total assets	$9,087.5	$8,197.8
Current liabilities	$2,499.0	$1,672.7
Long-term debt	1,017.8	889.7
Other liabilities	949.4	878.3
Total liabilities	$4,466.2	$3,440.7

The 1983 and 1982 Provisions related to Facility Utilization Plans in AT&T Technologies, Inc. represent charges to earnings to cover the costs of consolidating facilities and other reorganization plans.

(N) Debt Maturing Within One Year

Debt maturing within one year consists of the following:

	December 31, 1984	January 1, 1984	December 31, 1983
Notes payable:			
Bank loans	$ –	$ 19.6	$ 149.9
Commercial paper	172.2	578.0	1,529.4
Commercial notes	–	–	68.1
Other notes	2.2	22.4	5.1
Current portion of long-term lease obligations	112.2	94.4	–
Long-term debt maturing within one year	563.5	412.0	555.0
Total	$850.1	$1,126.4	$2,307.5

Through February 8, 1985 the Company has announced plans to call two issues of long-term debt outstanding. These issues, assumed from Pacific at divestiture, are as follows: $100.0 of 15½% debentures due in 2020 and $200.0 of 15⅛% debentures due in 1988. This debt has been reclassified from long-term debt and is now included in long-term debt maturing within one year.

(O) Long-term Debt

Interest rates and maturities on long-term debt outstanding at December 31, 1984 were as follows:

Maturities	2⅝% to 6⅞%	7% to 8⅞%	9% to 14.7%	Total
1986	$ 132.0	$ 15.0	$ 7.5	$ 154.5
1987	307.0	15.0	7.5	329.5
1988	7.0	15.0	7.5	29.5
1989	7.0	15.0	407.5	429.5
1990-1999	2,151.0	529.0	1,575.0	4,255.0
2000-2009	500.0	2,408.1	45.0	2,953.1
2010-2019	–	300.0	–	300.0
Total	$3,104.0	$3,297.1	$2,050.0	$8,451.1
Long-term lease obligations				268.5
Other				25.8
Unamortized discount–net				(27.9)
Total				$8,717.5

(P) Stock Options and Employee Incentive Plans

The Company has two employee incentive plans that provide for the granting of stock and/or options to purchase the Company's common stock to selected key employees of the Company. Under the AT&T Long Term Incentive Plan, units equal to the value of one common share are distributed to senior managers upon the achievement of specified financial and management effectiveness objectives. During 1984, 398,051 units were awarded with an average value of $17.94 per unit.

Under the AT&T 1984 Stock Option Plan, a maximum of 20,000,000 shares are available for grant of options to selected key employees of the Company beginning on January 1, 1984. The option price for outstanding options is the average quoted market price on the date of the grant. This plan shall expire December 21, 1993 unless previously terminated. During 1984, options were granted for future purchase of 1,508,372 shares of common stock at an average exercise price of $17.89 per share, exercisable one year after date of grant, and stock appreciation rights for 62,863 shares were granted at an average exercise price of $17.86, exercisable at least six months after date of grant. No options were exercised in 1984. As of December 31, 1984, 18,491,628 shares were available for future grants under the Stock Option Plan.

(Q) Preferred Shares

The Company has 100,000,000 authorized shares of preferred stock at $1 par value. The outstanding issues are as follows:

$3.64 preferred shares having a $50 stated value–9,400,000 shares are outstanding. These shares may be redeemed by the Company at a premium of $2.50 per share on or before April 30, 1985 and at a diminishing premium thereafter. During each of the years 1984 and 1983, the Company redeemed 300,000 of these shares.

$3.74 preferred shares having a $50 stated value–9,700,000 shares are outstanding. These shares may be redeemed by the Company at a premium of $2.56 per share on or before January 31, 1986 and at a diminishing premium thereafter. During 1984, the Company redeemed 300,000 of these shares.

$77.50 preferred shares having a $1000 stated value–525,000 shares are outstanding. These shares may be redeemed by the Company at a premium of $48.70 per share on or before January 31, 1986 and at a diminishing premium thereafter. During each of the years 1984, 1983 and 1982, the Company redeemed 12,500 of these shares.

The $3.64 and $3.74 issues described above contain a requirement for sinking fund redemption each year of 3% of the shares without premium; an additional 3% may also be redeemed at the Company's option. For the $77.50 preferred shares, on February 1 of each year through 1992 the Company must redeem 12,500 of these shares through a sinking fund at stated value; thereafter the requirement is 18,750 shares each year; an equal number may be redeemed at the Company's option each year.

The total sinking fund requirements for all series of preferred shares subject to mandatory redemption are $42.5 per year for 1985 through 1989. These sinking fund requirements are cumulative; that is, should redemption amounts not be set aside in full because the net assets of the Company are insufficient, or for any other reason, such amounts must be set aside, without interest, before any common share dividends are paid or declared, or any common shares are purchased or redeemed.

All preferred shares rank prior to the common shares both as to dividends and on liquidation but have no general voting rights. However, if dividends on any series of preferred shares are in default in an amount equal to six quarterly dividends, the number of directors of the Company will be increased by two, and the holders of all preferred shares will have the

DOLLARS IN MILLIONS (except per share amounts)

exclusive right, voting separately as a class, to elect such two additional directors so long as such default continues.

At December 31, 1982, following conversion of 685,509 shares during that year, the Company had 6,002,712 shares of $50 stated value, $4 cumulative convertible preferred stock outstanding. All shares outstanding at September 30, 1983 were redeemed at the stated value.

(R) Common Shareowners' Equity

Book value per common share amounted to $13.27 at December 31, 1984; $12.81 at January 1, 1984; $62.92 at December 31, 1983, and $69.07 at December 31, 1982. On May 23, 1983, the par value was changed from $16⅔ per share to $1 per share.

Common shares outstanding increased in the periods indicated as follows:

	1984	1983	1982
Beginning balance	**$ 965.7**	$896.4	$815.1
Conversion of cumulative convertible preferred shares	**–**	6.0	.7
Shares issued through underwritten offerings	**–**	17.6	27.7
Shares issued under share owner plans	**44.7**	31.7	28.3
Shares issued under employee plans	**27.3**	14.0	17.9
Other	**–**	–	6.7
Ending balance	**$1,037.7**	$965.7	$896.4

Additional paid-in capital increased in the periods indicated as follows:

	1984	1983	1982
Beginning balance	**$6,597.8**	$32,128.1	$27,699.1
Conversion of cumulative convertible preferred shares	**–**	275.7	33.6
Shares issued through underwritten offerings	**–**	1,125.5	1,578.6
Shares issued under share owner plans	**696.1**	1,852.3	1,464.6
Shares issued under employee plans	**460.1**	900.2	987.9
Divestiture adjustments (S)	**93.3**	–	–
Other	**(4.0)**	8.0	364.3
Ending balance	**$7,843.3**	$36,289.8	$32,128.1

(S) Other Information

In the Statement of Changes in Financial Position, funds from external sources include settlements of divestiture cash flow, divestiture asset assignment, and other claims that increased funds by $175.1, of which $81.8 is included in retained earnings and $93.3 is included in additional paid-in capital in the Balance Sheet. In addition, investment in property, plant and equipment–net increased by $541.0 resulting from reallocation and true-up of reserves previously accrued for restructuring the corporation and adjusting the carrying value of assets.

Miscellaneous–net in the 1984 Statement of Retained Earnings includes the settlements of divestiture cash flow, divestiture asset assignment, and other claims which increased retained earnings by $81.8 and cumulative foreign exchange translation adjustments which reduced retained earnings by $39.9.

(T) Quarterly Financial Information (unaudited)

Summarized quarterly financial results for 1984 and 1983 are as follows:

Calendar Quarter	Total Operating Revenues	Total Operating Expenses	Net Income	Earnings Per Common Share**
1984 1st	**$8,139.3**	**$7,699.2**	**$ 226.9**	**$ .20**
2nd	**8,627.3**	**7,832.6**	**455.5**	**.43**
3rd	**8,009.9**	**7,502.0**	**317.3**	**.28**
4th	**8,411.0**	**7,859.5**	**370.2**	**.33**
Total	**$33,187.5**	**$30,893.3**	**$1,369.9**	**$1.25**
1983 1st	$17,025.7	$13,330.0	$1,736.6	$1.87
2nd	17,707.0	13,908.8	1,928.8	2.03
3rd	17,713.5	13,890.7	1,458.0	1.51
4th	17,872.8	16,208.8	623.2*	.62*
Extraordinary charge (B)			(5,497.9)	(5.87)
Total	$70,319.0	$57,338.3	$ 248.7	$ .13

*Income before extraordinary charge.

**Because of increasing numbers of common shares outstanding each quarter, the sum of quarterly earnings per common share may not equal earnings per common share for the year.

1984

Quarterly results have been affected by adjustments and charges relating to divestiture, access charge estimates and billing from the local exchange companies, new methods of revenue reimbursement, and litigation expenses.

Third Quarter–During the third quarter the Company reallocated $600.0 of reserves previously accrued for restructuring the corporation and for adjusting the carrying value of assets in order to provide for the cost of the expansion of the AT&T Technologies cost reduction program. Net income was reduced by $51.2 as a result of adjustments to estimated access charges, which were partially offset by reductions in other reserves previously accrued.

Second Quarter–Includes a $75.4 charge to expense as a result of the settlement of pending litigation cases.

1983

As discussed in Note (B), 1983 results include an end of year extraordinary charge to reflect the impact of divestiture. Quarterly results also include special charges relating to litigation, divestiture, and restructuring the business.

Fourth Quarter–Includes a $175.5 reduction in net income due to the award of damages in a civil antitrust suit filed by Litton Industries, Inc. against the Company. Results for this quarter also include $724.0 nonrecurring charges, net of taxes, made to reflect the cost of consolidating

operations and forming new entities in compliance with FCC and divestiture related reorganization plans.

Third Quarter–Includes a $213.0 reduction in net income for consolidating operations and starting new entities in compliance with FCC and divestiture related reorganization plans.

Second Quarter–Includes a $190.0 charge to expense by AT&T Technologies, Inc. to cover the costs of consolidating distribution and repair facilities. Results for the second quarter also include an adjustment to recognize settlement of the Pacific tax matter. This adjustment increased net income by $216.4. See Note (I).

(U) Pending Litigation

MCI Antitrust Litigation–In June 1980, MCI Communications Corporation ("MCI") was awarded $1.8 billion in treble damages in a civil antitrust suit against the Company. In January 1983, the United States Court of Appeals for the Seventh Circuit reversed in part and remanded the case to the lower court for a new trial on damages on certain issues. The United States Supreme Court denied petitions to review the case in 1983. MCI also now is seeking to include damages relating to non-private line services. In November 1984, the Court of Appeals denied a petition by the Company to construe its January 1983 decision to exclude non-private line damages. The new trial is expected to begin in 1985. In the opinion of the Company's legal counsel, any monetary liability or financial impact to which the Company might be subject after final adjudication would not be material in amount.

Any liabilities resulting from the foregoing pending litigation will be apportioned among AT&T and the BOCs.

Supplementary Data

Accounting for the Effects of Inflation (Unaudited)

High rates of inflation in the years prior to 1979 drew increased attention to the need to assess both the impact of inflation on business and the results of management's efforts in coping with it. The Financial Accounting Standards Board ("FASB"), believing that additional experience should be gained and experimentation undertaken with respect to reporting the effects of inflation, issued Statement of Financial Accounting Standard No. 33 ("Statement No. 33") in 1979 which required disclosure of supplementary data to reflect the effects of general inflation (constant dollar) and the effects of changes in specific prices (current cost). Inflation continues to erode the purchasing power of the dollar, although the rate of inflation has slowed significantly in recent years. In 1984, the FASB issued an amendment to Statement No. 33 which eliminated certain historical cost/constant dollar information previously required. The data in Tables A and B have been prepared to comply with Statement No. 33 as amended. The Company believes that this information should be used with care because it neither completely nor accurately portrays inflation's effects.

In the "current cost" method of estimating the effects of inflation, financial statement elements are restated to reflect the changes in specific prices of fixed assets and of the goods and services that the Company purchases or manufactures. These changes in specific prices affect earnings and stockholders equity through changes in inventory values, depreciation, and cost of sales. The Company's current cost estimates are based primarily on internally-developed indices reflecting changes in labor and material costs, and on appraised valuations of property, published price indices and current suppliers' prices.

Table A–presents "income from continuing operations" as if depreciation of assets had been based on current cost asset amounts expressed in dollars of constant purchasing power. In computing "income from continuing operations" only depreciation expense and cost of sales have been adjusted to show the effects of inflation. Because most other operating expense items are current year transactions, they are already recorded in dollars of approximately current purchasing power.

As can be seen from the current cost adjustments in Table A, the Company's inflation-adjusted net income from continuing operations is less than one-half of the income reported in the historical cost financial statements. This indicates that inflation has had a significant impact on the replacement cost of the Company's inventories and property, plant and equipment, with a resulting theoretical increase in costs and expenses. The impact of applying the concept of current cost to the Company's financial statements is not as great as might otherwise be expected because the January 1, 1984 carrying value of terminal equipment and network facilities is stated at the amount expected to be recovered in the competitive environment.

In accordance with requirements of Statement No. 33, no adjustments have been made to reflect any effects of inflation on provision for income taxes. The effective income tax rate (provision for income taxes divided by the sum of provision for income taxes and income from continuing operations) for the historical data in Column (a) of Table A is 29.8 percent. This rate reflecting adjustments for inflation would be 50.0 percent for Column (b) of Table A. While the income taxes used in these computations include investment tax credits and tax deferrals relating to accelerated depreciation, the effects of inflation on effective tax rates also would be increased dramatically, even though in lower percentages, if these tax benefits were excluded. These tax benefits were intended by Congress to provide for funds for investment in other capital assets in order to increase productivity and employment.

The reader is cautioned, however, that inflation adjusted data does not represent the financial consequences of actual operations of the Company. The Company does not plan to replace or dispose of its plant on any large scale. Furthermore, the environment of inflation is a condition which affects all business entities, rather than relating specifically to the Company's operations.

Table B–presents selected financial data adjusted for the effects of changing prices. Amounts shown as "net assets at year end" in Table B are the sum of common shareowners' equity, and convertible preferred shares in the years 1980-1982, and equal to common shareowners' equity in the years 1983 and 1984, as adjusted for changes in specific prices by the difference between plant and inventories at historical cost and plant and inventories at current cost. Statement No. 33 also requires that the data shown in Table B be presented in a five year summary, restated into the average purchasing power of the dollar during 1984. The calculations for these restatements (except market price per common share) have been made by applying the average CPI-U for 1984 to the data for the years 1979 through 1983. The calculations for market price per common share have been made by applying the average CPI-U for 1984 to the data for the years 1980 through 1984.

Since the actual market price for 1984 is stated in year end dollars which have a lower purchasing power than the average 1984 dollar, the effect of the calculation for 1984 is to decrease the year end market price per common share from the actual quoted amount. No adjustments have been made to the historical cost information, which is presented for comparison purposes only.

Tables A and B contain an item identified as "purchasing power gain on net monetary items." During periods of inflation lenders of money experience a loss due to the fact that amounts owed to them will be repaid in dollars having less purchasing power than the dollars originally lent; it is in anticipation of such loss that interest rates are high during inflationary times. Conversely, to the extent that lenders are losing purchasing power, borrowers are benefiting. In 1984, the Company experienced a $277.7 purchasing power gain on net monetary items, indicating that total liabilities requiring a future fixed cash settlement amount exceeded like assets. It should be noted that this is a hypothetical gain, which is excluded from income.

Table A
Supplementary Financial Data
Adjusted for the Effects of Inflation and Changing Prices
December 31, 1984

DOLLARS IN MILLIONS	As Reported in the Historical Cost Financial Statements (a)	Adjusted for Changes in Specific Prices (Current Cost) (b)
Sales and revenues	$33,187.5	$33,187.5
Total operating costs and expenses excluding depreciation expense	28,115.4	27,974.3
Depreciation expense	2,777.9	3,707.7
Provision for income taxes	581.5	581.5
Other income and expenses	342.8	342.8
Income from continuing operations	$ 1,369.9	$ 581.2
Purchasing power gain on net monetary items		$ 277.7
Increase in specific prices (current cost) of inventories, property, plant and equipment held during the year		$ 1,472.1

Table B
Supplementary Five-Year Comparison of Selected Financial Data

Due to divestiture, 1984 financial results are not comparable to prior years.

DOLLARS IN MILLIONS (except per share amounts)	**Post-divestiture 1984**	Pre-divestiture 1983	1982	1981	1980
Operating revenues in average 1984 dollars	**$33,187.5**	$72,357.0	$70,022.2	$66,315.0	$63,856.5
Historical cost information:					
Income from continuing operations	**$ 1,369.9**	$ 5,746.6	$ 6,992.0	$ 6,822.9	$ 5,967.8
Income from continuing operations per common share[1]	**1.25**	6.00	8.06	8.47	8.04
Net assets at year end	**13,762.9**	60,762.4	62,214.4	55,630.7	50,009.0
Historical cost information adjusted for changes in specific prices (average 1984 dollars):					
Income (loss) from continuing operations	**$ 581.2**	$ (684.9)	$ 1,525.2	$ 2,422.0	$ 2,362.8
Income (loss) from continuing operations per common share[1]	**.46**	(.88)	1.62	2.86	3.00
Increase (decrease) in current cost of inventories and property, plant and equipment held during the year net of general inflation	**1,359.6**	(1,201.7)	(7,171.8)	6,581.6	6,857.3
Net assets at year end	**24,440.9**	140,228.8	150,003.5	138,719.3	138,161.2
Other information:					
Purchasing power gain on net monetary items	**$ 277.7**	$ 2,578.8	$ 3,098.1	$ 6,272.4	$ 8,697.1
Cash dividends declared per common share:					
At historical cost	**$1.20**	$5.85	$5.40	$5.40	$5.00
In average 1984 dollars	**1.20**	6.10	5.81	6.16	6.31
Market price per common share at year end:					
At historical cost[2]	**$19.50**	$61.50	$59.38	$58.75	$47.88
In average 1984 dollars	**19.23**	63.02	62.86	64.93	57.63
Average CPI-U	**311.1**	298.4	289.1	272.4	246.8

[1]Income from continuing operations per common share is after preferred dividend requirements. [2]Using Composite Tape closing price.

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**Effective February 1, 1985
†Retiring effective February 15, 1985

AT&T

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